(13)

No. 05-1429
Title: Travelers Casualty and Surety Company of America, Petitioner
v.
Pacific Gas and Electric Company
Docketed: May 10, 2006
Lower Ct: United States Court of Appeals for the Ninth Circuit
Case Nos.: (04-15605)
Decision Date: February 7, 2006

Questions Presented

~~Date~~	~~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~~~
May 8 2006	Petition for a writ of certiorari filed. (Response due June 9, 2006)
Jun 7 2006	Order extending time to file response to petition to and including July 7, 2006.
Jun 9 2006	Brief amicus curiae of Surety & Fidelity Association of America filed.
Jul 7 2006	Brief of respondent Pacific Gas and Electric Company in opposition filed.
Jul 25 2006	Reply of petitioner Travelers Casualty and Surety Company of America filed. (Distributed)
Jul 26 2006	DISTRIBUTED for Conference of September 25, 2006.
Oct 2 2006	DISTRIBUTED for Conference of October 6, 2006.
Oct 6 2006	Petition GRANTED.
Oct 31 2006	SET FOR ARGUMENT ON Tuesday, January 16, 2007.
Nov 10 2006	Consent to the filing of amicus briefs in support of either party received from counsel for the petitioner.
Nov 16 2006	Consent to the filing of amicus briefs in support of either party received from counsel for the respondent.
Nov 20 2006	Joint appendix filed.
Nov 20 2006	Brief of petitioner Travelers Casualty and Surety Company of America filed.
Nov 20 2006	Supplemental Joint appendix filed.
Nov 20 2006	Brief amicus curiae of Surety & Fidelity Association of America filed.
Nov 20 2006	Brief amicus curiae of American Insurance Association filed.
Nov 29 2006	CIRCULATED.
Dec 1 2006	Record received from U.S.C.A. for 9th Circuit. (1 envelope)
Dec 22 2006	Record received from U.S.D.C. for the Northern District of California. (1 box and 1 envelope)
Dec 22 2006	Brief amici curiae of Richard Aaron, et al. filed. (Distributed)
Dec 26 2006	Brief of respondent Pacific Gas and Electric Company filed. (Distributed)
Dec 26 2006	Lodging request received from respondent.

Jan 9 2007	Reply of petitioner Travelers Casualty and Surety Company of America filed. (Distributed)

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No. 05-

IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Petitioner and Respondent entered into a contract that included a provision that Petitioner is entitled to recover its attorneys' fees incurred in connection with the enforcement, protection, or litigation of its contractual and legal rights. Petitioner incurred attorneys' fees litigating its rights during the course of Respondent's bankruptcy case and sought to recover them from Respondent. Adhering to its prior decision in *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), the Ninth Circuit held that Petitioner could *not* recover its attorneys' fees because the relevant litigation in the bankruptcy court involved issues of federal bankruptcy law. The court reasoned that, as a matter of general federal common law, a party may not recover its attorneys' fees pursuant to a contract or state statute where the issues litigated involve matters of federal law because only federal law may authorize such a recovery. The question presented is:

Should the Court grant certiorari to resolve a conflict among nine courts of appeals concerning whether a litigant may recover attorneys' fees under a contract or state statute where the issues litigated involve matters of federal bankruptcy law?

PARTIES TO THE PROCEEDING

Petitioner is Travelers Casualty & Surety Company of America ("Travelers"), as Administrator for Reliance Insurance Company for itself, as successor-in-interest by merger with United Pacific Insurance Company, and for related Reliance Insurance Companies. Travelers is owned by Travelers Home Insurance Group Holdings, Inc., which, in turn, is owned by Travelers Property Casualty Corp., which, in turn, is owned by The St. Paul Travelers Companies, Inc. The St. Paul Travelers Companies, Inc. is a publicly traded company. Respondent is Pacific Gas and Electric Company ("PG&E").

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PRELIMINARY STATEMENT

This matter arises out of the chapter 11 bankruptcy case of respondent PG&E. Travelers issued surety bonds in favor of PG&E before PG&E commenced its bankruptcy proceeding, and PG&E executed a series of indemnity agreements in favor of Travelers in connection with Travelers' issuance of the bonds. Among other things, the indemnity agreements provide that PG&E is responsible for Travelers' attorneys' fees incurred in pursuing, protecting, or litigating its rights in connection with the indemnity agreements or the bonds.

During PG&E's bankruptcy case, Travelers incurred attorneys' fees in the course of asserting its rights, objecting to its treatment in the case, and defending litigation that PG&E brought against Travelers. The relevant proceedings and litigation involved questions of federal bankruptcy law. Travelers asserted a claim against PG&E for its attorneys' fees.

Adhering to its prior decision in *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), the Ninth Circuit held that Travelers could *not* have a claim for its attorneys' fees as a matter of law. The court reasoned that, although parties may be free to contractually allocate between them the burden of attorneys' fees incurred in litigating *state* law issues, they cannot do so with respect to litigating *federal* issues unless federal law specifically authorizes the allocation. Incorporating by reference its reasoning in *DeRoche v. Arizona Indus. Comm. (In re DeRoche)*, 434 F.3d 1188 (9th Cir. 2006), *reh'g denied*, No. 04-15258 (9th Cir. Feb. 8, 2006),[1] the Ninth Circuit determined that, even if a litigant has a general right to attorneys' fees under applicable state law, either by virtue of a contract valid under state law or by virtue of a state statute, the litigant's general right to fees cannot extend to fees incurred in litigating bankruptcy issues because federal law does not *authorize*

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[1] A petition for writ of certiorari will also be filed in the *DeRoche* case.

such a recovery. Significantly, no federal statute directs or requires this result. Instead, the court simply applied its rule as a matter of general federal common law.

Three other courts of appeals apply the *Fobian* rule in the context of litigating bankruptcy issues and have denied any right to attorneys' fees. *See Burns v. Great Lakes Higher Ed. Corp. (In re Burns)*, 3 Fed. Appx. 689, 691 (10th Cir. 2001) (unpublished); *BankBoston, N.A. v. Sokolowski (In re Sokolowski)*, 205 F.3d 532, 535 (2d Cir. 2000); *In re Sheridan*, 105 F.3d 1164, 1166-68 (7th Cir. 1997).

In contrast, five courts of appeals reject the *Fobian* analysis and allow the recovery of attorneys' fees in the context of litigating federal bankruptcy issues if allowed under applicable state contract law or state statute. *See Cadle Co. v. Martinez (In re Martinez)*, 416 F.3d 1286, 1290-91 (11th Cir. 2005) (rejecting Seventh Circuit's decision in *Sheridan* and Ninth Circuit's *Fobian* analysis as applied in *Renfrow v. Draper*, 232 F.3d 688, 694 (9th Cir. 2000)); *Three Sisters Partners LLC v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843, 848 (4th Cir. 1999) (rejecting *Fobian*, concluding that it "inappropriately focuses on the presence of issues peculiar to bankruptcy law, rather than on whether the attorneys' fees are properly taken in furtherance of the [relevant contract] and applicable state law"); *Alport v. Ritter (In re Alport)*, 144 F.3d 1163, 1168 (8th Cir. 1998) (rejecting *Fobian*); *Davidson v. Davidson (In re Davidson)*, 947 F.2d 1294, 1298 (5th Cir. 1991) (allowing fees); *Transouth Fin. Corp. of Fl. v. Johnson*, 931 F.2d 1505, 1507-09 (11th Cir. 1991) (allowing fees); *Jordan v. Southeast Nat'l Bank (In re Jordan)*, 927 F.2d 221, 226-27 (5th Cir. 1991) (allowing fees); *Martin v. Bank of Germantown (In re Martin)*, 761 F.2d 1163, 1168 (6th Cir. 1985) (allowing fees).

The conflict presented here is specifically recognized in the leading treatise on bankruptcy law, which criticizes *Fobian*. *See* 4 COLLIER ON BANKRUPTCY, ¶ 506.04[3][a] (15th ed. 2006) (discussing *Fobian* and stating that "[o]ther courts [of appeals] have expressly rejected *Fobian*, and properly concluded that a claim for attorney's fees arising in the context of litigating

bankruptcy issues must be allowed if valid under applicable state law") (citations omitted).

As recognized by several courts of appeals, the *Fobian* rule conflicts with prior precedents of this Court, which have concluded that the question of attorneys' fees is a matter of state, rather than federal, law. *See Security Mortgage Co. v. Powers*, 278 U.S. 149, 154 (1928) (concluding that the determination of a claim for attorneys' fees in bankruptcy presents "a question of local law"); *In re Martin*, 761 F.2d at 1168 (following *Security Mortgage* and concluding that creditor was entitled to fees).

The issue presented is important and recurring. The conflict among the courts of appeals is longstanding, widespread, entrenched, and unlikely to resolve itself absent intervention by this Court. This case presents an ideal vehicle to resolve the conflict because the court of appeals resolved the matter by applying the *Fobian* rule exclusively as an issue of law, and the resolution of the question presented is outcome-determinative. Finally, the decision below is plainly wrong. Under the *Fobian* rule, private parties are barred from contractually allocating the burden of attorneys' fees between them if the litigated issues involve questions of federal law, even though no federal statute expressly bars this common practice. The *Fobian* rule makes no sense and is plainly contrary to this Court's preemption precedents. *See O'Melveny & Myers v. FDIC*, 512 U.S. 79, 83, 87-88 (1994) (stating that "[t]here is no federal general common law" and that there must be a "significant conflict between some federal policy or interest and the use of state law . . . as a precondition for recognition of a federal rule of decision" in order to avoid becoming "awash in 'federal common-law' rules") (citations omitted). Accordingly, Travelers respectfully requests that the Court issue a writ of certiorari. Alternatively, Travelers requests that the Court summarily reverse the decision below.

OPINIONS BELOW

The opinion of the court of appeals, Pet. App. 1a, is unpublished, but can be found at 2006 WL285977 (No. 04-15605) (9th Cir. Feb. 7, 2006). The opinion of the district court, Pet. App.,

4a, is also unpublished, as is the opinion of the bankruptcy court, Pet. App. 20a.

JURISDICTION

The court of appeals entered its judgment on February 7, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS OF LAW

The following statutory provisions are relevant to this petition:[2] 11 U.S.C. §§ 101(5), (12); 501; 502. Rule 3003 of the Federal Rules of Bankruptcy Procedure also is implicated. No provision of the Bankruptcy Code bars private parties from contractually allocating the burden of attorneys' fees between them in matters involving the litigation of federal bankruptcy issues.

STATEMENT OF THE CASE

A. PG&E's Bankruptcy Case And Travelers' Proof Of Claim

On April 6, 2001 (the "Petition Date"), PG&E filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. For several years prior to PG&E's bankruptcy filing, Travelers issued a variety of surety bonds on PG&E's behalf to various third parties, including the $100 million bond at issue in this matter that assures PG&E's payment of workers' compensation benefits to its employees.[3]

In connection with Travelers' agreement to issue bonds on behalf of PG&E, PG&E executed a series of indemnity agreements

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[2] The relevant text of these provisions is reproduced in Petitioner's Appendix. *See* Pet. App. 27a.

[3] The bonds were necessary for PG&E to qualify for "self-insurance" under California's workers' compensation laws. *See* CAL. LABOR CODE §§ 3700 & 3701(c) (West 2003).

in favor of Travelers, pursuant to which PG&E became obligated to indemnify Travelers in full in the event that Travelers is ever required to make payment under any of the bonds. PG&E is further obligated to reimburse Travelers for any attorneys' fees that it incurs in connection with Travelers' efforts to enforce or protect its rights incident to the bonds. The indemnity agreements provide in relevant part:

> NOW, THEREFORE, in consideration of the execution of any [of the Bonds] . . . we, the Undersigned [PG&E], agree and bind ourselves . . as follows . . . [to] indemnify, and keep indemnified, and hold and save harmless the Surety [Travelers] against all demands, claims, loss, costs, damages, *expenses and attorney's fees* whatever and all liability therefor, sustained or incurred by the Surety [Travelers] by reason of executing . . . [the Bonds] . . . or sustained or incurred by reason of making any investigation on account thereof, prosecuting or defending any action brought in connection therewith, . . . recovering or attempting to recover any salvage in connection therewith or *enforcing by litigation or otherwise any of the agreements herein contained* [including all of Travelers' rights].

ER 41, 45 at ¶ "SECOND"[4] (emphasis supplied).

In its bankruptcy case, PG&E obtained an order from the bankruptcy court authorizing, but not obligating, it to continue paying workers' compensation benefits to its injured employees. ER 1. The order did not require PG&E to continue paying benefits after it emerged from bankruptcy.[5]

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[4] Citations to "ER" are to pages of the Excerpts of the Record filed with the Ninth Circuit below.

[5] In other chapter 11 cases in which the debtor has been authorized to pay workers' compensation benefits, the debtor has discontinued doing so during the course of the case, requiring the surety to pay benefits under its bond. *See Aetna Cas. & Sur. Co. v. Clerk of*

Shortly after the Petition Date, a "bar date" was established, setting a deadline for the filing of "proofs of claim" against PG&E. *See* Fed. R. Bankr. P. 3003(c)(3); *see also* 11 U.S.C. § 501(a) (creditor may file proof of claim). A bar date is significant because a creditor who fails to file a proof of claim by the deadline is generally not entitled to vote on the debtor's reorganization plan or receive any distributions from the debtor on account of claims that were not timely filed. *See* Fed. R. Bankr. P. 3003(c)(2).

On or about September 5, 2001, Travelers timely filed a proof of claim (the "Proof of Claim"), asserting its contractual and common law rights as a surety. ER 3.[6] Among other things, Travelers held a "contingent" reimbursement claim against PG&E (a contractual claim for reimbursement under the indemnity agreements for any loss that Travelers might sustain under its bond, such as by having to pay workers' compensation benefits). A proof of claim of this type must be timely filed or the creditor will be forever barred from recovery against the debtor if the contingency ever ripens. *See Employee Ret. Corp. v. Osborne (In re THC Fin. Corp.)*, 686 F.2d 799 (9th Cir. 1982) (creditor who failed to file proof of contingent claim was barred from recovery). The indemnity agreements specifically provide for Travelers' right of indemnity, and Travelers detailed its right of indemnification in its Proof of Claim.

Travelers also explained in its Proof of Claim that, in the event that it must ever pay benefits under the bond, Travelers would also have a right of subrogation -- i.e., the right to "step into the shoes" of the injured employee whom Travelers pays and assert the employee's rights against PG&E to recover what Travelers has

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United States Bankr. Court (In re Chateaugay Corp.), 89 F.3d 942, 945-46 (2d Cir. 1996) (despite authorization, debtor stopped paying benefits during its case and surety was required to pay $38 million to cover debtor's obligations).

[6] *See* 4 AM. JUR. 2D SURETYSHIP, § 182 (1974) ("Where the surety has satisfied [its obligation], the principal is bound to indemnify him, irrespective of any express contract of indemnity.").

paid to the employee. ER 5. Under the Bankruptcy Code, if a creditor (such as an injured employee) fails to file a proof of claim, the surety who is obligated to pay the creditor on the debtor's behalf may file the claim in the creditor's stead. *See* 11 U.S.C. § 501(b).[7] Thus, in addition to filing a claim for itself, Travelers also filed a claim on behalf of all of the workers who hold workers' compensation claims against PG&E and whom Travelers might someday have to pay. ER 6. By doing so, Travelers protected both the rights of the employees and its own interests.

B. Travelers' Objections To PG&E's Disclosure Statement

During its bankruptcy case, PG&E filed a disclosure statement (the "Disclosure Statement") describing its proposed reorganization plan (the "Plan"). *See* 11 U.S.C. § 1125. To protect its contractual and common law rights, Travelers objected to PG&E's Disclosure Statement because it did not adequately describe how PG&E's Plan would treat its workers' compensation obligations or Travelers' subrogation rights, and also objected to any impairment of Travelers' indemnity rights. ER 53-60. Travelers explained the importance of PG&E's failure to disclose the proposed treatment of the claims held by workers entitled to receive workers' compensation benefits, and inquired as to PG&E's intentions. ER 71. The bankruptcy court recognized the deficient disclosure and asked PG&E's corporate parent (the "Parent")[8] what it intended to do with the claims. ER 72 ("But let's take a simple answer. What is the fate of pre-petition worker's comp claimants under the post-confirmation regime?"). The Parent replied: "[W]hat we're prepared to do, regardless of what the current state of affairs is, is just to add a statement that makes clear that the claims of the workers themselves will pass through with the reorganized debtor remaining obligated to pay for them." *Id.* Travelers inquired: "The magic words I'm hoping to

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[7] The surety's right of subrogation is preserved in bankruptcy. *See* 11 U.S.C. § 509(a).

[8] The Parent was the principal proponent of PG&E's Plan.

hear, perhaps I am hearing them, is that they're rendered unimpaired." ER 73. The bankruptcy court then stated: "Unimpaired." *Id.* The Parent replied: "Yes." *Id.*

Travelers then inquired about the treatment of its subrogation rights: "What we'd also like to know is whether our subrogation rights are being rendered unimpaired under 509(a). Simply put, that solves the problem." ER 74. The bankruptcy court asked: "Can we have a position on that?" *Id.* The Parent replied: "Your Honor, I don't believe a subrogation right is a claim against the debtor. It's the right to step into someone else's claim and whatever that treatment is, it is." *Id.* The bankruptcy court stated: "Yeah, that's what I thought too. You don't have a separate claim, you just take over the claim." ER 75. To this Travelers replied: "As long as nothing in the plan will, or purports to impair Travelers' subrogation rights, I'll settle for that." *Id.* The bankruptcy court then proposed a revision of the Disclosure Statement to resolve Travelers' objection, to which PG&E and the Parent agreed. *Id.*

The parties then negotiated specific language to be inserted into the Disclosure Statement and Plan to implement this agreement. ER 80. The parties agreed that the Plan would provide that workers' claims to workers' compensation benefits would be placed in their own class and rendered unimpaired, and that the Plan would not impair any right that Travelers would have to be subrogated to the claims of workers in the event that Travelers were ever called upon to make payment under the bonds (the "Negotiated Language").

C. PG&E's Unilateral Modification Of The Negotiated Language And Pursuit Of Litigation With Travelers

PG&E ultimately reneged on its agreement, unilaterally modified the Negotiated Language, and sued Travelers. Rather than proceeding in accordance with its prior agreement, PG&E added language to the Plan, asserting that "[n]othing herein shall affect . . . the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of any such subrogation rights [of Travelers]." ER 87 ¶ 4.21, 88 ¶ 11.21, 91 ¶ 4, 93 ¶ 22, 94 ¶ 21.

Then, on or about March 18, 2002, PG&E commenced litigation against Travelers by filing an objection to Travelers' Proof of Claim (the "Objection"). ER 95. In its Objection, PG&E argued that *all* of Travelers' rights and claims had to be disallowed, did not exist, or were "not valid." ER 101-11. PG&E also asked the court to disallow the claims that Travelers had filed on behalf of the injured workers under section 501(b) of the Code. ER 108-09. PG&E clearly challenged and sought to eliminate or impair Travelers' reimbursement and subrogation rights. Compelled to defend its state law rights, Travelers opposed the Objection and objected to the Plan. ER 112-66.

Following negotiations, PG&E and Travelers entered into a stipulation (the "Stipulation") to "fully resolve all objections to the Claims without further litigation." ER 170. Travelers agreed to the disallowance of its direct reimbursement claim (other than for its attorneys' fees), subject to Travelers' right to seek reconsideration in the event that Travelers is ever obligated to make payment under its bond. ER 171. Travelers' subrogation rights, including any priority to which Travelers may be subrogated, were preserved. ER 171-72. Finally, PG&E remained obligated to pay all of its workers' compensation obligations in full.

PG&E's failure to provide adequate disclosure until after litigation; its unilateral decision to alter the Negotiated Language; and its needless litigation with Travelers thereafter, caused Travelers to incur significant attorneys' fees in the defense of its rights. If Travelers had not acted to protect its rights, Travelers' rights and claims may have been discharged. To this end, the Stipulation expressly provides: "Subject to the right of a party in interest to object as provided herein, Travelers may assert its claim for attorneys' fees under the Indemnity Agreements as a general unsecured claim against PG&E." ER 172. On November 8, 2002, the bankruptcy court approved the Stipulation. ER 174.

D. Travelers' Amended Proof Of Claim And PG&E's Objection

Pursuant to the Stipulation, Travelers filed its amended proof of claim (the "Amended Claim") on or about January 6, 2003, seeking to recover the attorneys' fees it incurred in protecting its indemnity and subrogation rights during the course of PG&E's chapter 11 case, including fees incurred in pursuing its objection to the Disclosure Statement and those incurred in defending against PG&E's Objection to Travelers' claims and rights. ER 175. PG&E objected to the Amended Claim, contending, *inter alia*, that Travelers could not recover attorneys' fees for bankruptcy-related matters (the "Second Objection"). ER 266. *See* 11 U.S.C. § 502.

At a July 11, 2003 hearing, the bankruptcy court sustained PG&E's Second Objection solely on the legal ground that Travelers could not assert a claim for attorneys' fees under applicable circuit law. ER 373, 378-79. While recognizing that Travelers had the right to protect its interests, *see* ER 371, the court nonetheless ruled from the bench that Travelers' claim for attorneys' fees would be disallowed as a matter of law because they were incurred in the context of adjudicating bankruptcy-related issues, *id.* In reaching its conclusion, the bankruptcy court relied on the Ninth Circuit's prior decision in *Fobian* and subsequent cases that have followed it.

On appeal, the district court affirmed on the same ground. ER 391, 396. The district court observed that the bankruptcy court did not reach the issue of the reasonableness of Travelers' claim. ER 390. The court stated: "This is because the bankruptcy court ultimately found that Travelers' claim for attorneys' fees should be disallowed because 'as a matter of bankruptcy law, they cannot be assessed against the Debtor in any amount.'" *Id.* The district court also relied on the Ninth Circuit's decision in *Fobian* and its progeny.

On further appeal, the Ninth Circuit affirmed. Pet. App. 1a. Applying its *Fobian* rule, the Ninth Circuit found that a contractual right to attorneys' fees is enforceable only "if state law governs the substantive issues raised in the proceedings." *Id.* at 3a. Stating that "attorneys' fees are not recoverable in bankruptcy for litigating

issues 'peculiar to federal bankruptcy law,'" the Ninth Circuit held that Travelers could not recover its attorneys' fees because the dispute arose in connection with PG&E's Disclosure Statement, Plan, and objections to Travelers' claims and rights. *Id.* at 2a-3a.

REASONS FOR GRANTING THE WRIT

The petition should be granted because the decision below deepens an entrenched conflict among the courts of appeals. In denying Travelers' claim for attorneys' fees, the Ninth Circuit followed its longstanding precedent in *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), to hold that a party cannot pursue a contractual right to attorneys' fees if the issues litigated involve questions of federal law, unless federal law authorizes the party's contractual arrangement. Three other courts of appeals also apply the *Fobian* rule in the context of litigating bankruptcy matters. In contrast, five courts of appeals reject the *Fobian* analysis and allow the recovery of attorneys' fees in the context of litigating federal bankruptcy issues if allowed under applicable contract law or state statute. Intervention by this Court is required because the conflict among the courts of appeals is longstanding, widespread, entrenched, and unlikely to resolve itself on its own.

The Court's intervention also is warranted because the issue presented is an important and recurring problem and because, as recognized by several courts of appeals, the *Fobian* rule conflicts with prior precedents of this Court, in which the Court has concluded in the bankruptcy context that the question of attorneys' fees is a matter of state, rather than federal, law.

This case presents an ideal vehicle to resolve the conflict because the court below resolved the matter applying the *Fobian* rule exclusively as an issue of law, and resolution of the question presented is outcome-determinative. Finally, the decision of the court below is demonstrably wrong. Accordingly, Travelers respectfully requests that the Court issue a writ of certiorari to review the decision of the court below. Alternatively, Travelers requests that the Court summarily reverse the decision below.

A. The Ninth Circuit's Decision Deepens A Square Circuit Conflict.

The Ninth Circuit held in this case that "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'" Pet. App. 3a. In doing so, the court relied on its prior decision in *Fobian*. ER 303, 371-73, 396. The lower courts in this case also cited or relied on previous decisions of the Ninth Circuit adhering to the *Fobian* rule, including *Renfrow v. Draper*, 232 F.3d 688 (9th Cir. 2000); *American Express Travel Related Servs. Co. v. Hashemi (In re Hashemi)*, 104 F.3d 1122 (9th Cir. 1997); and *Ford v. Baroff (In re Baroff)*, 105 F.3d 439 (9th Cir. 1997). Pet. App. 10a, 13a, 15a-17a, 23a-25a. *See also Thrifty Oil Co. v. Bank of Am. Nat'l Trust & Sav. Assoc.*, 322 F.3d 1039, 1059-60 (9th Cir. 2003); *Stenga v. 4M 2B Investors (In re 4M 2B Investors)*, 116 F.3d 483 (9th Cir. 1997) (unpublished); *Alvarado v. Walsh (In re LCO Enters., Inc.)*, 105 F.3d 665 (9th Cir. 1997) (Table); *Johnson v. Righetti (In re Johnson)*, 756 F.2d 738, 740-41 (9th Cir. 1985); *Collingwood Grain, Inc. v. Coast Trading Co., Inc.*, 744 F.2d 686, 693 (9th Cir. 1984).

In *Fobian*, the debtors filed for bankruptcy relief after defaulting on mortgage debt to a secured creditor. In the bankruptcy proceeding, the creditor sought to protect and defend its rights under sections 506 and 1225 of the Bankruptcy Code (which governed the treatment of the secured creditor's claim). The creditor incurred attorneys' fees pursuing its rights under these statutory provisions and claimed that it was entitled to its fees under the terms of its contractual loan agreement. Observing that the application of sections 506 and 1225 are matters of federal law, the Ninth Circuit concluded that any right to attorneys' fees incurred in connection with litigating the proper application of these provisions is also a matter of federal law, regardless of the applicability of the underlying provisions of the contract. The court stated: "[W]here the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law, attorneys' fees will not be awarded absent bad faith or harassment by the losing party." 951 F.2d at 1153.

Under *Fobian*, private parties are prohibited from contractually allocating the burden of attorneys' fees between them unless federal law authorizes the agreement. In other words, *Fobian* holds that contracts otherwise valid under state law (such as mortgage loan agreements, sales contracts, and the like) cannot, as a matter of law, allocate responsibility for a party's litigation expenses unless Congress has expressly *authorized* the allocation in some manner. This rule is plainly wrong and has the analysis exactly backwards. Clearly, the correct rule is that contracts that are valid under state law may allocate litigation costs among the parties unless Congress has expressly *prohibited* them from doing so. *See Security Mortgage*, 278 U.S. at 154. Nevertheless, three other courts of appeals -- the Second, Seventh, and Tenth -- apply the *Fobian* rule. *See Burns v. Great Lakes Higher Ed. Corp. (In re Burns)*, 3 Fed. Appx. 689, 691 (10th Cir. 2001) (unpublished); *BankBoston, N.A. v. Sokolowski (In re Sokolowski)*, 205 F.3d 532, 535 (2d Cir. 2000); *In re Sheridan*, 105 F.3d 1164, 1166-68 (7th Cir. 1997).

In contrast, five courts of appeals -- the Fourth, Fifth, Sixth, Eighth, and Eleventh -- focusing in particular on this Court's decisions, follow the rule that creditors may recover fees incurred in litigating federal bankruptcy issues. *See Cadle Co. v. Martinez (In re Martinez)*, 416 F.3d 1286, 1290-91 (11th Cir. 2005); *Alport v. Ritter (In re Alport)*, 144 F.3d 1163, 1168 (8th Cir. 1998); *Three Sisters Partners LLC v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843, 848 (4th Cir. 1999); *Davidson v. Davidson (In re Davidson)*, 947 F.2d 1294, 1298 (5th Cir. 1991); *Transouth Fin. Corp. of Fl. v. Johnson*, 931 F.2d 1505, 1507-9 (11th Cir. 1991); *Jordan v. Southeast Nat'l Bank (In re Jordan)*, 927 F.2d 221, 226-27 (5th Cir. 1991); *Martin v. Bank of Germantown (In re Martin)*, 761 F.2d 1163, 1168 (6th Cir. 1985); *Worthen Bank & Trust Co. v. Morris (In re Morris)*, 602 F.2d 826, 829-30 (8th Cir. 1979).

For example, in *In re Martin*, 761 F.2d 1163 (6th Cir. 1985), the debtor executed a loan agreement granting the creditor the right to recover attorneys' fees incurred in collecting the loan. After the debtor filed for bankruptcy relief, the creditor objected to the debtor's bankruptcy discharge (plainly an issue of bankruptcy law)

and sought attorneys' fees in connection with collecting its loan in the bankruptcy court and challenging the discharge of the debtor. Following this Court's decision in *Security Mortgage*, the Sixth Circuit concluded that the creditor held a valid claim for its fees. 761 F.2d at 1168.

In *Three Sisters Partners LLC v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843 (4th Cir. 1999), the debtor executed a lease obligating it to pay the lessor's attorneys' fees in connection with the lessor's pursuit of its rights. After the debtor filed for bankruptcy, the lessor incurred attorneys' fees in connection with its efforts to recover its property and protect its interests by seeking relief under various provisions of the Bankruptcy Code and actively participating in the case. After the debtor "assumed" the lease (i.e., agreed to be bound by its terms notwithstanding its bankruptcy filing and its right to reject the lease), the lessor sought to recover its fees. The bankruptcy court denied recovery, reasoning on the basis of *Fobian* that the lessor could not recover fees for protecting its interests in the bankruptcy court or litigating bankruptcy issues. The Fourth Circuit reversed, holding that "the bankruptcy court erred to the extent that it applied a bright-line test precluding the award of fees for actions primarily involving issues of bankruptcy law." *Shangra-La*, 167 F.3d at 852. In doing so, the Fourth Circuit expressly rejected and criticized *Fobian*, stating that the Ninth Circuit's rule "inappropriately focuses on the presence of issues peculiar to bankruptcy law, rather than on whether the attorney's actions were reasonably undertaken in furtherance of purposes for which attorney's fees are properly recoverable under the terms of the [relevant contract] and applicable state law." *Shangra-La*, 167 F.3d at 848.

In addition to the conflict among the courts of appeals on the question presented, numerous lower courts have also adopted conflicting positions. *See, e.g., In re Fast*, 318 B.R. 183, 192-94 (Bankr. D. Colo. 2004) (allowing claim for attorneys' fees); *V.M. v. S.S. (In re S.S.)*, 271 B.R. 240, 244-46 (Bankr. D. N.J. 2002) (noting that claim, if properly presented, would be disallowed); *In re Crown Books Corp.*, 269 B.R. 12, 15-18 (Bankr. D. Del. 2001) (allowing recovery of attorneys' fees); *In re Hunter*, 203 B.R. 150,

151 (Bankr. W.D. Ark. 1996) (allowing recovery of attorneys' fees); *In re Ryan's Subs, Inc.*, 165 B.R. 465, 468-69 (Bankr. W.D. Mo. 1994) (disallowing claim for attorneys' fees); *In re Child World, Inc.*, 161 B.R. 349, 353-55 (Bankr. S.D.N.Y. 1993); *In re Best Prods. Co.*, 148 B.R. 413, 414-15 (Bankr. S.D.N.Y. 1992) (disallowing claim for attorneys' fees); *James R. Barnard, D.D.S., Inc. v. Silva (In re Silva)*, 125 B.R. 28, 30-32 (Bankr. C.D. Cal. 1991) (allowing recovery of attorneys' fees); *Commercial Factors of Salt Lake City v. Jensen (In re Jensen)*, 113 B.R. 51, 53-55 (Bankr. D. Utah 1990) (allowing recovery of attorneys' fees).

It is unlikely that the existing conflict among the courts of appeals on the question presented will resolve itself. The conflict is longstanding, widespread, and entrenched. Because the relevant issues have been fully vetted in numerous published opinions, it is also unlikely that allowing the conflict to continue will shed further light on how the question presented should be resolved. Accordingly, Travelers respectfully requests that the Court issue a writ of certiorari in this case.

B. The Decision Below Conflicts With This Court's Precedents And Is Plainly Incorrect.

As noted, the analysis and holdings of *Fobian* and its progeny rest on the proposition that, in litigation involving federal bankruptcy issues, the parties' contractual allocation of liability for attorneys' fees is invalid unless *authorized* by federal law. *See, e.g., Fobian*, 951 F.2d at 1153; *Johnson*, 756 F.2d at 741 (stating that "because federal [bankruptcy] law governs the disposition of this [bankruptcy question], it should also govern the disposition of the attorney's fee issue in this case" and concluding that, because no federal statute authorized recovery of attorneys' fees, the fees were not recoverable). As this Court has explained in the bankruptcy context, however, questions regarding a party's right to attorneys' fees is a matter of *state* law. The Ninth Circuit's *Fobian* rule thus has the analysis exactly backwards.

This Court determined long ago that, "[t]he construction of the contract for attorney's fees presents . . . a question of local law." *Security Mortgage*, 278 U.S. at 154. The Court acknowledged in

Security Mortgage that bankruptcy law *might* bar the enforceability of an entitlement to attorneys' fees against the debtor's property otherwise valid under state law in so far as Congress has the authority to enact such a rule preempting state law. *Id.* Critically, however, the Court found that bankruptcy law, in and of itself, does *not* actually present any such bar: "The character of the obligation to pay attorney's fees presents no obstacle to enforcing it in bankruptcy, either as a provable claim or by way of a lien on specific property." *Id.*

If an agreement allocating attorneys' fees is valid under state law, a creditor's right to payment of its attorneys' fees under that agreement constitutes a "claim" for bankruptcy purposes. 11 U.S.C. § 101(5). As this Court explained in *Security Mortgage*, the question then becomes whether federal bankruptcy law *disallows* the claim for attorneys' fees for some reason. *See* 11 U.S.C. § 502 (providing for disallowance of claims on certain enumerated grounds).

Under section 101(5), the term "claim" means any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5). As the Court has explained, the term "claim," as used in the Bankruptcy Code, is an expansive concept: "a 'claim' is defined . . . as a 'right to payment,' . . . and a 'right to payment,' we have said, 'is nothing more nor less than an enforceable obligation.'" *Cohen v. De La Cruz*, 523 U.S. 213, 218 (1998) (quoting *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559 (1990)). As the Court has further explained, the terms "claim" and "debt," as used in the Bankruptcy Code, are interchangeable -- the term "debt" being defined simply as "liability on a claim." *See Davenport*, 495 U.S. at 558 ("This definition reveals Congress' intent that the meanings of 'debt' and 'claim' be coextensive."). These definitions reflect "Congress' broad rather than restrictive view of the class of obligations that qualify as a 'claim' giving rise to a 'debt.'" *Id.* (citing H.R. Rep. No. 95-595, at 309 (1977) *reprinted in* 1978 U.S.C.C.A.N. 6266 (describing definition of "claim" as the "broadest possible" and

noting that the Bankruptcy Code "contemplates that all legal obligations of the debtor . . . will be able to be dealt with in the bankruptcy case").

In *Raleigh v. Illinois Dep't of Rev.*, 530 U.S. 15 (2000), the Court explained further that, for bankruptcy purposes, a particular "right to payment" is typically a matter of state law:

> Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code. The "basic federal rule" in bankruptcy is that state law governs the substance of claims, Congress having "generally left the determination of property rights in the assets of a bankrupt's estate to state law." "Unless some federal interest requires a different result, there is no reason why [the state] interests should be analyzed different[ly] simply because an interested party is involved in a bankruptcy proceeding."

530 U.S. at 20 (quoting *Butner v. United States*, 440 U.S. 48, 54-55 (1979); *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161-62 (1946)).

The Court's decision in *Cohen v. De La Cruz* also demonstrates that a right to attorneys' fees that is valid under state law is properly a "claim" for bankruptcy purposes. In *Cohen*, the Court considered, among other things, whether a creditor's claims for treble damages, costs, and attorneys' fees could be excepted from discharge. The creditor's claim rested on a state statute providing for damages, including attorneys' fees. 523 U.S. at 223. The relevant dispute in *Cohen* arose in the context of a dischargeability proceeding -- a proceeding unique to federal bankruptcy law involving whether a particular debt would be subject to the debtor's bankruptcy discharge. *Id.* at 215. Considering the scope of the term "debt" and the question whether the term encompassed state law liability for treble damages, costs, and attorneys' fees, the Court concluded that the obligations were all valid "debts" for bankruptcy purposes. *Id.* at 223.

There is thus no reason to conclude that Travelers' claim for attorneys' fees is somehow barred as a matter of substantive bankruptcy law, which expressly *recognizes* a state law right to attorneys' fees as a proper bankruptcy claim. Accordingly, the Ninth Circuit's *Fobian* rule amounts to "what one might call 'federal common law' in the strictest sense, *i.e.*, a rule of decision that amounts, not to simply an interpretation of a federal statute or a properly promulgated administrative rule, but, rather, to the judicial 'creation' of a special federal rule of decision." *Atherton v. FDIC*, 519 U.S. 213, 218 (1997) (citing *Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 640-43 (1981)). But under this Court's precedents, there simply is no basis for the creation of federal common law governing the ability of parties to enter into contracts allocating the burden of attorneys' fees in litigation involving federal bankruptcy issues.

The creation of a new federal common law rule of decision is justified in only the rarest of circumstances:

> The Court has said that "cases in which judicial creation of a special federal rule would be justified . . . are . . . 'few and restricted.'" *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 87 (1994) (quoting *Wheeldin v. Wheeler*, 373 U.S. 647, 651 (1963)). "Whether latent federal power should be exercised to displace state law is primarily a decision for Congress," not the federal courts. *Wallis v. Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966). Nor does the existence of related federal statutes automatically show that Congress intended courts to create federal common-law rules, for "'Congress acts . . . against the background of the total *corpus juris* of the states . . . .'" *Id.* at 68 (quoting H. Hart & H. Wechsler, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 435 (1953)). Thus, normally, when courts decide to fashion rules of federal common law, "the guiding principle is that a significant conflict between some federal policy or interest and the use of state law . . . must first be specifically shown." 384 U.S., at 68. Indeed, such a "conflict" is normally a "precondition." *O'Melveny, supra*, at 87. *See also United States v. Kimbell*

Foods, Inc., 440 U.S. 715, 728 (1979); *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 98 (1991).

Atherton, 519 U.S. at 218-19.

In *Atherton*, the Court noted that "[n]o one doubts the power of Congress to legislate rules for deciding cases," but recognized that none of the relevant statutes enacted by Congress actually provided a rule of decision, which, in that case, involved the applicable standard of care by which a party's conduct would be judged. 519 U.S. at 219. Acknowledging the absence of a federal standard, the Court remarked: "Consequently, we must decide whether the application of state-law standards of care . . . would conflict with, and thereby significantly threaten, a federal policy or interest." *Id.* Finding no such conflict, the Court allowed the state law standard to be applied. *Id.*

Critically, neither the decision below nor the prior Ninth Circuit cases it relied upon even undertook the analysis set forth in *Atherton*, which required that the Ninth Circuit proceed cautiously, bearing in mind that no provision of the Bankruptcy Code precludes Travelers' claim for attorneys' fees. *See* 519 U.S. at 218-19. The Ninth Circuit also was required to consider that "Congress acts . . . against the background of the total *corpus juris* of the states," and to determine whether there was a "significant conflict between some federal policy or interest and the use of state law," as such a showing is a "precondition" to the creation of a federal common law rule of decision. *Id.* at 218-19. Simply put, the Ninth Circuit did not undertake the required analysis in *Fobian* or any of its progeny.

The *Fobian* line of cases also conflicts with this Court's precedents restricting the ability of federal courts to establish categorically how claims are to be treated under the Bankruptcy Code. *See United States v. Noland*, 517 U.S. 535, 540-41 (1996); *United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213, 228-29 (1996). In *Noland*, the Sixth Circuit approved the categorical subordination of certain tax penalty claims. This Court reversed, concluding that the federal courts are not authorized to prescribe the categorical treatment of claims "at the same level at which Congress operated when it made its

characteristically general judgment to establish the hierarchy of claims in the first place." *Noland*, 517 U.S. at 540; *see also CF&I*, 518 U.S. at 228-29.

Applying the Court's reasoning in *Noland* and *CF&I* to the treatment of claims for attorneys' fees, the *Fobian* line of analysis is similarly "inappropriately categorical." *Noland*, 517 U.S. at 543. In essence, *Fobian* and its progeny establish that *all* claims for attorneys' fees arising from indemnity agreements must be categorically disallowed under the Bankruptcy Code if the fees relate to the litigation of bankruptcy issues. Policy judgments of this kind, however, are properly reserved for Congress, not the courts. Because Congress has not prescribed such a categorical exclusion in the Bankruptcy Code, the *Fobian* analysis is unsound. *See BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994) (proscribing "policy determinations that the Bankruptcy Code gives [the court] no authority to make").

Had Congress intended to create an exception to the allowance of claims for attorneys' fees by prohibiting claims for attorneys' fees incurred in pursuing, protecting, and defending rights in the context of a bankruptcy case because federal bankruptcy issues are involved, it could easily have done so. The fact that Congress did not create such an exception demonstrates conclusively that it intended no such exception to apply. *See FCC v. NextWave Pers. Communications, Inc.*, 537 U.S. 293, 302 (2003) ("where Congress has intended to provide . . . exceptions to provisions of the Bankruptcy Code, it has done so clearly and expressly"); *Toibb v. Radloff*, 501 U.S. 157, 161 (1991) (refusing to infer exception to section 109 of the Bankruptcy Code, stating, "Congress knew how to restrict recourse to the avenues of bankruptcy relief"); *Ohio v. Kovacs*, 469 U.S. 274, 279 (1985).

C. Alternatively, The Court Should Grant Summary Reversal.

Because the decision below is plainly in error, the Court may find it appropriate to consider summary reversal. Accordingly, pursuant to Supreme Court Rule 16.1, Travelers respectfully moves for summary reversal of the decision below.

CONCLUSION

For the foregoing reasons, the Court should grant the petition for writ of certiorari. Alternatively, Petitioner requests summary reversal.

Respectfully submitted,

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Dated: May 8, 2006

APPENDIX

APPENDIX A — MEMORANDUM OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT FILED FEBRUARY 7, 2006

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 04-15605

D.C. No. CV-03-03499-PJH

TRAVELERS CASUALTY AND SURETY COMPANY,

Appellant,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Appellee.

Argued and Submitted October 17, 2005
San Francisco, California

MEMORANDUM*

Before: REINHARDT and THOMAS, Circuit Judges, and RESTANI**, Chief Judge, Court of International Trade.

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* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

** The Honorable Jane A. Restani, Judge, United States Court of International Trade, sitting by designation.

Appendix A

Travelers Casualty and Surety Company ("Travelers") appeals the judgment of the district court affirming the bankruptcy court's denial of attorney fees. We affirm. Because the parties are familiar with the factual and procedural history of the case, we will not recount it here.

Travelers argues that *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir.1991), does not control this case and that *Fobian* was incorrectly decided. This appeal raises substantially the same issues as *DeRoche v. Arizona Industrial Commission (In re DeRoche)*, 434 F.3d 1188 (9th Cir.2006). For the reasons set forth in our opinion in *DeRoche*, Travelers' argument fails.

Travelers' argument is weaker than the argument asserted in *DeRoche*. Travelers is attempting to recover fees in bankruptcy for objections to proposed reorganization plans and related bankruptcy proceedings. Travelers' objection to the reorganization plan arose under 11 U.S.C. § 1125, and claimed only that the debtor failed to provide the required "adequate information" about the reorganization plan. Specifically, Travelers sought some assurance that its subrogation rights were being rendered unimpaired under 11 U.S.C. § 509(a). Nothing in the federal bankruptcy proceedings required Travelers to satisfy any of the obligations assured by, or to make any payment with respect to, any of its surety bonds or indemnity agreement with the debtor. Travelers did not prevail on any claim it asserted in the bankruptcy proceedings.

"[A] prevailing party in a bankruptcy proceeding may be entitled to an award of attorney fees in accordance with

applicable state law if state law governs the substantive issues raised in the proceedings." *Ford v. Baroff (In re Baroff)*, 105 F.3d 439, 441 (9th Cir.1997). However, attorney fees are not recoverable in bankruptcy for litigating issues "peculiar to federal bankruptcy law." *Fobian*, 951 F.2d at 1153.

The resolution of all of these proceedings was governed entirely by federal bankruptcy law. Both the bankruptcy court and the district court correctly denied Travelers' claim for attorney fees. Indeed, if unimpaired, non-prevailing creditors were authorized to obtain an attorney fee award in bankruptcy for inquiring about the status of unimpaired inchoate and contingent claims, the system would likely be overwhelmed by fee applications, with no funds available for disbursement to impaired creditors or debtor reorganization.

AFFIRMED.

APPENDIX B — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA DATED FEBRUARY 18, 2004

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

No. C-03-3499 PJH

In re: PACIFIC GAS AND ELECTRIC COMPANY,

Debtor.

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Claimant/Appellant,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Objector/Appellee.

ORDER AFFIRMING BANKRUPTCY COURT

Appellant Travelers Casualty & Surety Company of America ("Travelers") appeals the bankruptcy court's ruling sustaining debtor and appellee Pacific Gas and Electric Company's ("PG&E") objection to Traveler's amended proof of claim. For the reasons that follow, this court affirms the decision of the bankruptcy court.

Appendix B

Prior to PG&E's chapter 11 bankruptcy filing on April 6, 2001, Travelers[1] issued a $100 million surety bond on PG&E's behalf to the California Department of Industrial Relations ("DIR"). The bond guarantees PG&E's payment of state workers compensation benefits to injured employees. In conjunction with the bond, PG&E also executed a series of continuing agreements of indemnity to Travelers in the event of a default.

To date, PG&E has not defaulted on its workers compensation obligations, and Travelers has not had to assume any liability pursuant to the bonds as a result of default. In fact, on the same day that PG&E filed for bankruptcy relief, it obtained an order from the bankruptcy court authorizing it to continue making its workers compensation payments in accordance with its pre-petition obligations.

On September 5, 2001, prior to the bar date for claims, Travelers filed a protective proof of claim ("claim") in PG&E's bankruptcy case, asserting a claim *not for default*, but instead for future reimbursement and subrogation rights it possessed under the bonds and indemnity agreements. That is, Travelers filed the claim to protect its subrogation and/or indemnification rights in the event that PG&E, in the future, defaulted on it workers compensation payments and Travelers was required to make payments under its bond.

Around the same time, on September 20, 2001, PG&E filed its first plan of reorganization and disclosure statement,

1. This includes the entities to whom Travelers is a successor-in-interest.

to which Travelers objected on November 30, 2001, on the basis that the statement failed to provide adequate information regarding the disposition of the bonds and PG&E's obligations to Travelers under the bonds. On January 14, 2002, at a hearing on the disclosure statement, the court and the parties agreed that additional language would be added to the disclosure statement addressing Travelers' concerns. Subsequently, on March 7, 2002, PG&E filed its amended disclosure statement and plan of reorganization.

On March 18, 2002, PG&E objected to Travelers' claim on the grounds that it should be disallowed under controlling bankruptcy law. Thereafter, on July 16, 2002, Travelers filed an objection to the confirmation of PG&E's amended plan, arguing that the amended plan and PG&E's objection to Travelers' claim sought to impair Travelers' rights. At a November 8, 2002 hearing on PG&E's objections to creditors' claims, including Travelers among others, Travelers and PG&E represented that they had resolved the objection to Travelers' claim.

In that stipulation, subsequently approved by the bankruptcy court, the parties agreed that, other than the attorney's fees Travelers had incurred in the course of the bankruptcy proceedings, Travelers had not been called upon to satisfy any obligations or make payments under any of the bonds. Accordingly, the parties stipulated that Travelers' claim should be disallowed based on controlling bankruptcy law, namely section 502(e)(1)(B).[2] The parties agreed

2. Bankruptcy Code section 502(e)(1)(B) provides in pertinent part that ". . . . the [bankruptcy] court shall disallow any claim for

(Cont'd)

Appendix B

(Cont'd)

reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim to the extent that — (B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution."

The section was enacted "to prevent . . . competition between a creditor and [its] guarantor for limited proceeds of the estate." *Dant & Russell, Inc. v. Burlington Northern Railroad Co. (In re Dant & Russell)*, 951 F.2d 246, 248 (9th Cir. 1991)(citation omitted); 4 Collier on Bankruptcy § 502.06[2][d]. Accordingly, "section 502(e)(1)(B) is applicable to a debt owed by the debtor to a creditor which has been guaranteed by a third party." 4 Collier at § 502.06[2][d].

> If the primary obligee [in this case, PG&E workers with workers compensation claims] seeks payment from the guarantor [Travelers], the guarantor may seek reimbursement or contribution from the debtor [PG&E]. Both the primary obligee and the guarantor have a claim against the debtor that arises from the same debt; the primary obligee has a right to payment from the debtor, and the guarantor has a contingent right to reimbursement or contribution from the debtor which may become noncontingent in the event that [the debtor] fully satisfies the primary obligee's claim [workers]. By disallowing the guarantor's contingent claim for reimbursement or contribution, section 502(e)(1)(B) insures that the estate will not be liable to the primary obligee and the guarantor for the same debt.

Id.; *see also In re Dant & Russell*, 951 F.2d at 248 (noting that "a claim will be disallowed under § 502(e)(1)(B) only if (1) the claim is for reimbursement or contribution; (2) the party asserting the claim is liable with the debtor on the claim of a creditor; and (3) the claim is contingent at the time of allowance or disallowance").

however, that the disallowance did not apply to Travelers' claim for attorney's fees. Nor did the disallowance prejudice Travelers' (1) right to seek reconsideration of the disallowance in the event that, in the future, Travelers was indeed required to make payment(s) under the bonds, or (2) Travelers' subrogation rights under applicable law. Likewise, the parties agreed that the stipulation did not impair PG&E's ability to oppose a motion for reconsideration or "to object to Travelers' asserted subrogation rights." The stipulation then set forth a procedure by which Travelers would assert its claim for attorney's fees.

On January 6, 2003, Travelers submitted its amended proof of claim for attorney's fees and costs totaling over $167,000. PG&E objected to the claim on several bases, including that Travelers failed to provide sufficient documentation in support of the claim, that the fees were not compensable under the bonds or indemnity agreements, that the fees were not reimbursable based on controlling bankruptcy law, and that the fees were unreasonable.

On July 7, 2003, the bankruptcy court held a hearing on PG&E's objection to Travelers' claim for attorney's fees. After considering the parties' briefs and arguments, the court sustained PG&E's objection to Travelers' claim for attorney's fees and disallowed the claim. It subsequently entered the order sustaining the objection on July 11, 2003. Travelers appealed, and elected to have the appeal heard by this court.

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ISSUE

This appeal involves one issue: Whether the bankruptcy court erred when it sustained PG&E's objection to Travelers' claim for attorney's fees as a matter of bankruptcy law.

DISCUSSION

As noted, Travelers' claim in this case relates only to the attorney's fees that it has expended protecting its rights pursuant to the bonds and indemnity agreements. There is no dispute that Travelers has incurred no other liability pursuant to the bonds, and that PG&E has never defaulted on the workers compensation payments.

On appeal, the parties somewhat misconstrue the bankruptcy court's July 7, 2003 ruling and the basis for its disallowance of Travelers' claim for attorney's fees. The bankruptcy court overruled PG&E's objections regarding the adequacy of Travelers' claim and did not reach the reasonableness of the claim. This is because the bankruptcy court ultimately found that Travelers' claim for attorney's fees should be disallowed because "as a matter of bankruptcy law, they cannot be assessed against the Debtor in any amount." Exh. 37 at 78.

A. Standard of Review

This court "will not disturb the bankruptcy court's refusal to award attorney's fees to [a creditor] unless the court erroneously applied the law or abused its discretion." *Renfrow v. Draper*, 232 F.3d 688, 693 (9th 2000).

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B. Bankruptcy Law Framework

"There is no general right to recover attorney's fees under the Bankruptcy Code." *Renfrow*, 232 F.3d at 693 (citing *Kord Enterprises II v. California Commerce Bank (In re Kord Enterprises II)*, 139 F.3d 684, 687 (9th Cir. 1998)); *accord Ford v. Baroff (In re Baroff)*, 105 F.3d 439, 441 (9th Cir. 1997). "However, a prevailing party in a bankruptcy proceeding may be entitled to an award of attorney's fees in accordance with applicable state law if state law governs the substantive issues raised in the proceedings." *In re Baroff*, 105 F.3d at 441 (citing *Johnson v. Righetti (In re Johnson)*, 756 F.2d 738, 741 (9th Cir. 1985)). "Because state law necessarily controls an action on a contract, a party to such an action is entitled to an award of fees if the contract provides for an award and state law authorizes fee shifting agreements." *Id.*

Nevertheless, attorney's fees are not available despite an express contractual provision "if the 'substantive litigation raise[s] federal bankruptcy law issues rather than basic contract enforcement questions.'" *Id.* (citing *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991)). This is because "the question of the applicability of the bankruptcy laws to particular contracts is not a question of the enforceability of a contract but involves a unique, separate area of federal law." *In re Fobian*, 951 F.2d at 1153 (citation omitted).

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C. Analysis

Travelers argues here, as it did below, that its attorney's fees, which it contends were contemplated by the indemnity agreements, are allowable under Ninth Circuit law because they were incurred as a result of Travelers' efforts to preserve its state law rights, including its indemnity rights under the contracts and its subrogation rights under California law.[3] Alternatively, Travelers argues that Ninth Circuit law is wrong and contrary to U.S. Supreme Court precedent.

The bankruptcy court rejected both arguments in disallowing Travelers' claim for attorney's fees. It refused to characterize PG&E's objections to Travelers' rights and claims under the bonds and indemnity agreements, in the course of the bankruptcy proceedings, as anything other than "pure Bankruptcy Code challenges." *Id.* at 76. It noted that the proceedings regarding Travelers' rights were nothing more than "a pure bankruptcy 502 type challenge," and that there was no risk any greater than that which creditors normally face in a bankruptcy case.[4] The court further concluded that the Supreme

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3. Travelers argues that it is entitled to its fees pursuant to contract and to state law. The Indemnity Agreements provide in relevant part that Travelers is entitled to attorney's fees sustained in "enforcing by litigation or otherwise any of the agreements. . . ." However, because the bankruptcy court concluded that federal bankruptcy law foreclosed attorney's fees in the case, it did not rule on the contract interpretation issue.

4. Bankruptcy Code section 502 deals with the allowance and disallowance of claims in a bankruptcy case, and provides the rules and procedures for determining allowable claims. *See generally* 4 Collier on Bankruptcy § 502.01.

Court case cited by Travelers was distinguishable, and that it was not inconsistent with the Ninth Circuit cases on point.

For the reasons that follow, this court affirms.

I. The Bankruptcy Court Applied the Appropriate Legal Standards

Travelers argues that this court should disregard Ninth Circuit precedent relied on by the bankruptcy court because it constitutes "a fundamental departure" from other Ninth Circuit and Supreme Court precedent.

On appeal, Travelers relies on two recent Ninth Circuit cases, both involving pre-petition litigation, for the proposition that its claim for attorney's fees is proper in this case. *See Abercrombie v. Hayden Corp. (In re Abercrombie)*, 139 F.3d 755 (9th Cir. 1998); *Kadjevich v. Kadjevich (In re Kadjevich)*, 220 F.3d 1016 (9th Cir. 2000).[5] However, Travelers fails to mention that the post-petition attorney's fees at issue in both of those cases arose from pre-petition litigation or collection efforts. *See Abercrombie*, 139 F.3d at 756 (state supreme court awarded creditor attorney's fees in breach of contract action initiated by debtor three years prior to bankruptcy); *Kadjevich*, 220 F.3d at 1018 (creditor/brother of debtor brought breach of settlement agreement and fraud action against debtor two years prior to bankruptcy filing). In other words, the debtor in *Kadjevich* defaulted prior to filing for bankruptcy protection, and the creditors in both *Kadjevich* and *Abercrombie* pursued litigation or collection

5. Interestingly, this is not an argument that Travelers made before the bankruptcy court.

actions in state court prior to the bankruptcy filings. Accordingly, the facts and the legal issues in those cases were quite distinct from the situation here.

As noted, it is undisputed that there were no pre-petition collection efforts or litigation related to the bonds or indemnity agreements in this case *since there was no default.* Moreover, the legal issue in *Abercrombie* and *Kadjevich* was distinct from that here, and involved whether or not the attorney's fees in those cases should be treated as priority administrative expenses under the Bankruptcy Code or simply as nonpriority claims. There is no issue as to priority or administrative expense in this case. Therefore, neither case undermines the controlling Ninth Circuit precedent, as applied by the bankruptcy court and by this court on appeal.

Nor is this Ninth Circuit precedent inconsistent with the Supreme Court and other Ninth Circuit cases on which Travelers relies. Travelers contends that the Ninth Circuit's decisions in *In re Fobian*, *Renfrow*, and *Baroff* are contrary to the Supreme Court's 1928 decision in *Security Mortgage Co. v. Powers*, 278 U.S. 154 (1928), the Supreme Court's more recent decision in *Cohen v. De La Cruz*, 523 U.S. 213 (1998), and the Ninth Circuit's 1964 decision in *Hartman v. Utley*, 335 F.2d 558 (9th Cir. 1964). *All* of these cases, however, are distinguishable from the case at hand, and none call into question the Ninth Circuit's holdings in the controlling cases. *See, e.g., Security Mortgage*, 278 U.S. at 152-53 (*oversecured* creditor may recover portion of attorney's fees incurred in pursuing collection action on a defaulted secured note in state court); *Cohen*, 523 U.S. at 218-19 (concluding that creditors' claim for treble damages,

attorney's fees and costs awarded pursuant to state consumer fraud act were nondischargeable pursuant to Bankruptcy Code § 523); *Hartman*, 335 F.2d at 559 (allowing portion of surety's attorney's fees incurred *following the debtor's default* under surety bond).

II. The Bankruptcy Court Appropriately Characterized the Proceedings Giving Rise to Travelers' Attorney's Fees as Pure Bankruptcy Litigation

Travelers argues that the fees and expenses that it incurred in the course of PG&E's bankruptcy case were incurred primarily to protect its indemnification and subrogation rights, which it contends are state law rights. Below, in making this argument, Travelers seemed to distinguish between its contingent indemnification or reimbursement rights and its subrogation rights, focusing primarily on its subrogation rights. Presumably, this was because the treatment of Travelers' contingent reimbursement (also known as indemnification) rights was clearly controlled by Bankruptcy Code section 502(e)(1)(B), the stipulated basis for the disallowance.[6] *See also* Exh. 37 at 20-22, 46 (noting

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6. Below, Travelers argued that it had to object to PG&E's disclosure statement "in order to determine if its subrogation rights would remain following" PG&E's reorganization. Travelers also contended that it was forced to respond to PG&E's efforts to cut off its subrogation rights by objecting to PG&E's plan. In focusing specifically on its subrogation rights, Travelers noted that it:

> never had any objection to having our contingent reimbursement claim disallowed. That was not an issue.

(Cont'd)

that Travelers was forced to protect its rights in part because PG&E allegedly sought to treat its subrogation rights the same as its contingent reimbursement claims). On appeal, though, Travelers does not make the same distinction. *See* Travelers' Opening Br. at 18 ("[I]n this instance, Travelers incurred its fees in connection with the pursuit and protection of its state-law subrogation *and* reimbursement rights.")(emphasis added).

Even though the parties and the bankruptcy court correctly recognized that there may be a distinction regarding the treatment of prospective subrogation rights and contingent reimbursement rights under the Bankruptcy Code, any such distinction, however, is not dispositive of the ultimate issue on appeal. The attorney's fees that Travelers expended in "protecting" its rights, whether they are characterized as contingent reimbursement or subrogation rights, should be disallowed for the reasons applied in the Ninth Circuit's *Fobian* and *Johnson* cases, reiterated by the Ninth Circuit in *Renfrow* and *Baroff*, and applied by the Ninth Circuit BAP in *Hassen Imports v. KWP (In re Hassen Imports Partnership)*, 256 B.R. 916 (9th Cir. 2000).

(Cont'd)

> We didn't litigate over that. We didn't press that. And we resolved the 502 issue in our stipulation. But what we were fighting about and what we fought about and what we had to brief in response to the Debtor's objection was that *a subrogation right is not the same thing as a contingent reimbursement claim.*

Exh. 37 at 49-50 (emphasis added).

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In *Johnson*, the Ninth Circuit held that the bankruptcy court erred when it applied state substantive law awarding fees to a creditor who prevailed in an action on a motion for relief from stay. 756 F.2d at 741. The court ruled that the stay litigation was not an "action on a contract," to which state law regarding attorney's fees applied. *Id.* at 740. Likewise, in *Fobian*, the Ninth Circuit held that a creditor who was the prevailing party in a plan confirmation battle, similar to Travelers' plan and disclosure statement objections here, was not entitled to attorney's fees because the litigation involved solely issues of federal bankruptcy law and could not be considered "an action on the contract." 951 F.2d at 1153. This was despite a provision in the promissory note and deed of trust providing for fees and costs incurred in the enforcement of the *Fobian* creditor's rights. *Id.*

In *Hassen*, it was the debtor who sought attorney's fees, but the facts and issues were similar to this case. The debtor in *Hassen* was a car dealership, and the creditor bank held a promissory note secured by a deed of trust on the debtor's real property. The debtor successfully defended a contentious motion for relief from stay, and a contentious plan confirmation battle. Subsequently, the debtor sought attorney's fees under state law related to the stay motion and the plan confirmation proceedings. The Ninth Circuit BAP rejected the debtor's "attempt[] to incorporate state substantive law in the context of the bankruptcy case." *Id.* at 923. In affirming the bankruptcy court, the appellate court noted: "The bankruptcy court correctly observed that the fight over confirmation was not an action on the Note, but an action on an entirely different contract: the Plan [of

Reorganization]." *Id.* Relying on *Johnson*, the *Hassen* court then held:

> Absent such a Congressional mandate, the state law of attorney's fees is simply inapplicable in a matter involving bankruptcy substantive law. We will not convert a bankruptcy issue into a state law question . . . based [on] how the parties drafted the Note. That would elevate form (of the Note) over substance (of the bankruptcy disputes). Stated otherwise, the nature of the issues litigated arise solely in bankruptcy and federal bankruptcy attorneys' fees policy is clear and well-settled and may not be abrogated by artful drafting.

Id.

Much like the debtor in *Hassen*, Travelers "seeks an award of attorneys' fees in uniquely bankruptcy matters, relying not on bankruptcy authority, but attempting to import [state law] into this exclusive federal setting." *Id.* at 920. The matters for which Travelers seeks attorney's fees involve exclusively bankruptcy proceedings, including the claims allowance process under section 502, and plan and disclosure statement objections and proceedings under chapter 11. For the reasons set forth in *Fobian*, *Renfrow*, *Baroff*, *Johnson*, and *Hassen*, the measures employed by Travelers cannot be considered "an action on the contract[s]" or bonds.

Nor is this court persuaded by Travelers' other arguments, appropriately rejected by the bankruptcy court. No one, including the bankruptcy court, has disputed

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Travelers' right to file a proof of claim in an attempt to protect its rights and its ability to move for reconsideration under Bankruptcy Code section 502(j) in the event of default. However, the propriety of filing the claim is not at issue. Instead, the issue is whether the bankruptcy estate is liable for the attorney's fees that Travelers incurred in filing the claim. As noted by the bankruptcy court, while Travelers "had every right to . . . protect[] its position by negotiating with the plan and disclosure statement," this court likewise disagrees that the estate is required to pay for Travelers' exercise of that right. *See* Exh. 37 at 77.

Moreover, as pointed out by the bankruptcy court, the worst case scenario that Travelers alluded to below and in its briefs before this court was highly unlikely. A default judgment was very unlikely given the fact that the events were occurring within the context of pure bankruptcy proceedings, the claims allowance process and plan confirmation, and no adversary proceeding was ever commenced. As noted by the bankruptcy court, it understood Travelers' argument that there:

> may be [something] lurking between the lines with something more than the objection to claim. I just simply don't buy it. I recognize that maybe you and your client had no choice but to protect your position. . . . but that I don't think there was a risk there. This was an objection to claims. It wasn't more than that, and I don't believe under the traditional default rule, you could have done any worse than have had the claims disallowed.

Id. at 76-77. This court likewise finds Travelers' dire predictions unconvincing. There is nothing to suggest that Travelers was

being treated differently than any other creditor or surety in the bankruptcy proceedings that would justify allowance of its attorney's fees in this case.

CONCLUSION

For the reasons above, the bankruptcy court's decision sustaining PG&E's objection to Travelers' claim for attorney's fees is AFFIRMED. Additionally, this court determines that oral argument is unnecessary pursuant to Federal Rule of Bankruptcy Procedure ("FRBP") 8012, as the facts and legal arguments are adequately presented in the briefs and record in this case, and oral argument would not significantly aid this court in its decision.

This order fully adjudicates the appeal and terminates all pending motions for this case. The clerk shall close the file.

IT IS SO ORDERED.

Dated: February 18, 2004

/s/
PHYLLIS J. HAMILTON
United States District Judge

APPENDIX C — ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, SAN FRANCISCO DIVISION DATED JULY 11, 2003

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

Case No. 01-30923 DM

Chapter 11 Case

Date: July 11, 2003
Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California

In re

PACIFIC GAS AND ELECTRIC COMPANY,
a California corporation,

Debtor.

Federal I.D. No. 94-0742640

ORDER ON DEBTOR'S OBJECTION TO AMENDED CLAIM OF TRAVELERS CASUALTY AND SURETY COMPANY, ET AL.

At the date and time set forth above, the Bankruptcy Court held a hearing on the objection (the "Objection") submitted by Pacific Gas and Electric Company, the debtor and debtor-in-possession in the above-captioned Chapter 11

case ("PG&E" or the "Debtor"), to the amended claim, assigned Claim No. 8869 (the "Amended Claim"), submitted by Travelers Casualty and Surety Company and certain related entities (collectively, "Travelers"). Appearances were as noted in the record.

The Court having considered the Objection, Travelers' Response to the Objection, the Debtor's Reply to such Response, the record in this case, and any admissible evidence and argument presented to the Court, hereby finds as follows:

A. Adequate notice of this proceeding was given to parties in interest as appropriate under the circumstances.

B. The Objection involves a matter of law which can be disposed of at the initial hearing on the Objection pursuant to Bankruptcy Local Rule 3007-1 for the Northern District of California.

C. There is good cause for sustaining the Objection.

Based on the foregoing, **IT IS HEREBY ORDERED** that the Objection is sustained and the Amended Claim is disallowed in its entirety, for the reasons stated on the record.

DATED: July 11, 2003

s/ Dennis Montali
HONORABLE DENNIS MONTALI
UNITED STATES BANKRUPTCY JUDGE

APPENDIX D — TRANSCRIPT OF PROCEEDINGS OF THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, SAN FRANCISCO DIVISION DATED JULY 11, 2003

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
(SAN FRANCISCO DIVISION)

Case No. 01-30923 DM

Chapter 11

San Francisco, California
July 11, 2003
1:29 p.m.

In re:

PACIFIC GAS AND ELECTRIC COMPANY,
a California Corporation,

Debtor.

TRANSCRIPT OF PROCEEDINGS
OBJECTION TO AMENDED CLAIM OF TRAVELERS CASUALTY & SURETY COMPANY, et al.

BEFORE THE HONORABLE DENNIS MONTALI
UNITED STATES BANKRUPTCY JUDGE

* * *

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[3] THE CLERK: Rise please. The court is now in session, The Honorable Dennis Montali presiding.

THE COURT: Good afternoon. Please be seated.

* * *

THE COURT: Okay. Listen. I appreciate all the work and all the sophisticated legal theories. I'm going to resist the temptation to take the matter under advisement. I'm going to sustain the Debtor's objections, Mr. Brunstad, and I'll explain myself.

First of all, what I'm going to overrule the Debtor, is on any adequacy of the Proof of Claim. Indeed, your Proof of Claim was filed, but without as much data and documentation as maybe it might have been, but we're dealing with experienced counsel who know how to exchange information and so, just as if I were going to have an evidentiary hearing, I might give the Debtor more time to [76] deal with the specifics that only came more recently, I'm not going to fault Travelers for having this Proof of Claim sort of gradually grow into the five-pound document it is.

So the Debtor's points on that theory are rejected. I'm satisfied, having listened to the arguments and looked at the documents and my familiarity with the cases — I won't lie to you; I didn't go back and read *Security Mortgage* this morning. But I'm going to tell you how I deal with the *Security Mortgage* argument.

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First of all, I do think Mr. Kaplan is correct that the challenges to the Travelers claim were in fact all Bankruptcy Code challenges. If he had filed an adversary proceeding to declare some or all of the indemnity agreements or the bonds or whatever invalid, and had gone for declaratory relief and certainly had sought that kind of relief, I might not come out the same way. But the legal theory of the Debtor's challenge to the claims is pure bankruptcy.

* * *

As far as the protecting — Travelers protecting its position by negotiating with the plan and the disclosure statement, of course, you had every right to do that. We're back to the same thing I said before; I just don't think the Debtor has to pay for it, because I think it's bankruptcy law.

So then I come to *Security Mortgage*, and of course, I can joke that we in the Ninth Circuit are — have our own rules here, but we do honor Supreme Court cases. I think *Security Mortgage* is distinguishable, but even if it isn't, I'm bound to follow Nine Circuit precedent, and you're going to have to convince the Ninth Circuit that it was wrong in all those other cases. And *Fobian* and *Renfrow* [78] and others, some of which I did simply refer to in that *Hassen Imports* case, they have made it clear to me, although I see it more often than not in a credit card dischargeability case that where liability is not an issue but dischargeability is, the creditor doesn't get his attorney's fees. Where liability is challenged and dischargeability is, the court has to sort it through. And I see no difference in other aspects of bankruptcy application, and I am not prepared to say that one little piece of concern

about what was sought in the objection to claim implicated your client's State law rights such that you can now invoke the attorney's fees provision.

So I don't think *Security Mortgage* has been ignored by the several Ninth Circuit cases, but even if it has, I'm bound to follow Ninth Circuit authority, and I'm going to follow it. And I think that Mr. Kaplan's arguments are well taken here. So I don't need to get to the question, and I won't address the question, of whether the fees were reasonable in whole or in part. I simple agree with Mr. Kaplan that as a matter of bankruptcy law, they cannot be assessed against the Debtor in any amount. So I will sustain the objections for those reasons. I will ask Mr. Kaplan to submit — he's already got it in his hand — submit a form of order that simply recites that the objections are sustained for the reasons stated on the [79] record.

MR. KAPLAN: Your Honor, may we approach with the proposed order?

THE COURT: Show it to counsel.

But, Mr. Brunstad, I do appreciate the very, very thorough legal analysis of the issues, and the fact that I may come out disagreeing with you doesn't mean I don't very much respect your analysis of the theories — or Mr. Kaplan's. And this is a stimulating and challenging area in a frankly obscure area of the law, as you know.

* * * *

APPENDIX E — RELEVANT STATUTES

11 U.S.C. § 101

§ 101. Definitions

In this title the following definitions shall apply:

* * *

(5) The term "claim" means—

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

* * *

(12) The term "debt" means liability on a claim.

Appendix E

11 U.S.C. §501

§ 501. Filing of proofs of claims or interests

(a) A creditor or an indenture trustee may file a proof of claim. An equity security holder may file a proof of interest.

(b) If a creditor does not timely file a proof of such creditor's claim, an entity that is liable to such creditor with the debtor, or that has secured such creditor, may file a proof of such claim.

(c) If a creditor does not timely file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim.

* * *

11 U.S.C. §502

§ 502. Allowance of claims or interests

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a

hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

> (1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;

* * *

(c) There shall be estimated for purpose of allowance under this section—

> (1) any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case; or
>
> (2) any right to payment arising from a right to an equitable remedy for breach of performance.

* * *

Supreme Court, U.S.
FILED
JUL 7 - 2006
OFFICE OF THE CLERK

No. 05-1429

In The Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,
Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF *CERTIORARI*

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QUESTIONS PRESENTED FOR REVIEW

1. A surety has issued bonds to assure a company's performance of certain obligations. The company files for bankruptcy, but has not defaulted and has embraced the underlying obligations. Even though the surety's position is unimpaired, it intervenes in the bankruptcy case to take steps that have no impact on its legal rights. Is it proper to deny the surety attorneys' fees under a contract that calls for the payment of fees in connection with "enforcing" its contractual rights?

2. The surety files a claim against the bankruptcy debtor, but then withdraws the claim, stipulating it was meritless. The surety further participates in the bankruptcy proceeding to enforce disclosure obligations that are purely a matter of bankruptcy law. Although the surety did not prevail, and its intervention did not secure any right that it would not have had by operation of law, the surety nevertheless seeks attorneys' fees. Was the Court of Appeals correct in rejecting the claim for attorneys' fees?

CORPORATE DISCLOSURE STATEMENT

Respondent Pacific Gas and Electric Company ("PG&E") is wholly owned by PG&E Corporation, which is a publicly traded company. No parent or publicly held company owns 10% or more of PG&E Corporation's stock.

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INTRODUCTION[1]

Petitioner Travelers Casualty & Surety Company of America ("Travelers") gratuitously intervened in the bankruptcy proceeding of Respondent Pacific Gas and Electric Company ("PG&E"). Although the bankruptcy did nothing to impair Travelers' position under its contracts with PG&E, Travelers hired a team of lawyers to file and defend a claim. It then stipulated the claim was meritless. Next, Travelers' legal team negotiated changes to various bankruptcy documents, even though (as the courts below all held) those changes did nothing to enhance or protect the rights Travelers already enjoyed by operation of law.

Travelers then presented PG&E with a bill for its attorneys' fees. It invoked a contractual provision requiring PG&E to reimburse any legal expenses Travelers might incur "enforcing" its contractual rights.

The Bankruptcy Court, District Court and Court of Appeals all agreed that Travelers could not recover its legal fees. So Travelers turns to this Court for a ruling that an *unimpaired* creditor who *unsuccessfully* intervenes in a bankruptcy proceeding and presses arguments that arise only under bankruptcy law should be permitted to siphon off funds from other creditors to pay its lawyers.

No court—at any level—has ever awarded attorneys' fees in this rather unique context. Travelers incorrectly argues that there is a "longstanding, widespread, [and] entrenched" conflict among the circuits on other applications of the rule the Court of Appeals invoked in reaching its conclusion, citing nine circuits that have supposedly lined up on either side of the line. Pet. 3. Never mind that not a

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[1]The Petition for Writ of Certiorari is cited as "Pet.," and the Appendix to the Petition is cited as "Pet. App." The Excerpts of Record and the Supplemental Excerpts of Record before the Court of Appeals are cited as "ER" and "SER," respectively. PG&E's Request for Judicial Notice filed with the Court of Appeals will be cited as "RJN."

single one of those nine circuits suggests that there is a split in authority on the rules to be applied to creditors seeking attorneys' fees. The truth is the cases are not in conflict on the general rule. The worst that can be said is that every once in a while circuits might reach different conclusions about fact-bound applications of the rule to certain situations not presented here.

Even if there were a conflict on the general rule, and it were squarely presented here, this case would still not be cert-worthy. First, the rule—even in its broadest application—governs a relatively small universe of creditors, and, even for them, the stakes are typically so low that litigation over these sorts of claims is uncommon. Moreover, this case is a poor vehicle for deciding the legal issue Travelers presents. En route to deciding that issue, this Court would have to grapple with a knotty question of contract interpretation that has no salience to anyone but the parties here. Beyond that, the rule the Court of Appeals applied is correct.

STATEMENT OF THE CASE

A. PG&E Files For Bankruptcy But Does Not Trigger Any Liability For Travelers.

PG&E filed a voluntary Chapter 11 bankruptcy petition in 2001. PG&E continued to operate and manage its business as a so-called "debtor in possession." *See* 11 U.S.C. §§1107(a), 1108. Contemporaneously with the petition, PG&E filed an "Emergency Motion" seeking permission to continue honoring its workers' compensation obligations. That very day, the Bankruptcy Court approved the request. Pet. App. 5a; ER 2. There is no dispute that PG&E has satisfied its workers' compensation obligations, and has never suggested that it had any intention of defaulting on them. Pet. App. 5a.

This is a critical fact from the perspective of Travelers' financial exposure. Travelers had issued surety bonds to third parties assuring PG&E's performance of its obligation to pay workers' compensation benefits. Pet. App. 5a. In a series of indemnification agreements, PG&E, in turn, had agreed to indemnify Travelers in the event Travelers is ever called upon to cover a defaulted payment under the surety bonds. Pet. App. 5a; ER 5-6, 168-70. But, as the courts below all recognized and Travelers stipulated, "Travelers has not had to assume any liability pursuant to the bonds as a result of default" because "PG&E has not defaulted on its workers' compensation obligations." Pet. App. 5a; *see* Pet. App. 2a; ER 170. In other words, the bankruptcy filing did not saddle Travelers with any burdens, and did not impair Travelers' financial or legal position in any way. Pet. App. 2a.

B. Travelers Files A Claim, But Stipulates It Is Meritless.

Nevertheless, Travelers filed a claim against PG&E in the bankruptcy proceeding. ER 3. This claim (which the parties have referred to as the "Original Claim") did not assert that PG&E defaulted, nor that PG&E currently owed Travelers any money. Pet. App. 5a. Rather, the claim was based upon the contingency that PG&E might some day default on its workers' compensation obligations, and in the event it did, Travelers could be liable for the payments. *Id.* If Travelers ever did make those payments, it would have two rights. First, it would have the right to turn to PG&E and demand reimbursement for the outlay. *Id.* Second, it would have a right of subrogation—the right to stand in the shoes of any injured employees whose payments it covered and assert their claims. *Id.* Travelers asserted nothing but these contingent reimbursement and subrogation rights.

PG&E objected to the claim, asserting an ironclad defense: "[C]ontingent" claims of this sort have no place in a bankruptcy proceeding; in bankruptcy parlance, they are "disallowed." *See* 11 U.S.C. §502(e)(1)(B) ("the court shall disallow any claim . . . to the extent that . . . such claim . . . is contingent . . ."); *id.* §509. Only reimbursement claims that have actually materialized, by virtue of a default of the underlying obligations, are allowable. Otherwise, the debtor would be liable to the primary obligee (here, the injured employee) and the surety (Travelers) for the same debt. Similarly, prospective or contingent subrogation rights are not valid claims in a bankruptcy proceeding. *See* 11 U.S.C. §509(a).

Travelers' legal team wrote a brief arguing that its claim was allowable. ER 112. But before the Bankruptcy Court could resolve the issue, Travelers conceded otherwise. It entered into a stipulation that the claim was disallowed because "Travelers has not been called upon to satisfy any of the obligations assured by, or to make any payment with respect to, any of its Surety Bonds or the Indemnity Agreements." ER 170-71. Based on this stipulation, the Bankruptcy Court disallowed the claim. ER 174.

The parties also stipulated that "[n]othing [in the stipulation] shall prejudice or impair Travelers' subrogation rights under applicable law, or the Debtor's right to object to Travelers' asserted subrogation rights." ER 171. As the Bankruptcy Court observed, this provision did not reserve for either party a benefit that it would not have had as a matter of right without regard to this term. ER 319-20.[2]

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[2]The same can be said of another term of the stipulation, which preserved Travelers' statutory right to reconsideration of the disallowance of its claims under certain circumstances (*see* 11 U.S.C. §502(j)) and PG&E's right to oppose any such reconsideration. *See* ER 171.

The stipulation also acknowledged that Travelers was free to assert a claim for reimbursement of the attorneys' fees it incurred in connection with pursuing the claim it withdrew. ER 172-73. If valid, this claim for attorneys' fees would be treated like any other unsecured debt. ER 172. That was an empty assurance, for the parties also agreed that PG&E would be free to object to any such claim. *Id.*

C. The Reorganization Plans All Preserve PG&E's Workers' Compensation Obligations.

In any Chapter 11 bankruptcy, the documents that shape subsequent duties and obligations are the plan of reorganization (as confirmed by the bankruptcy court) and the related disclosure statement. There is no dispute that every iteration of PG&E's plan and disclosure statement—and, indeed, every iteration of all the competing plans proposed by creditors—undertook that PG&E would continue to comply fully with all of its workers' compensation obligations. SER 2, 4-5. Nor did any proposed plan or disclosure statement purport to limit or modify any of PG&E's obligations to Travelers or any of Travelers' subrogation rights. Travelers has never asserted its reimbursement or subrogation rights were in jeopardy. *See* SER 7-12.

Nevertheless, Travelers demanded additional assurances. The parties negotiated what is often called "comfort language"—unnecessary, but innocuous, language that soothes the creditor without conveying any real legal benefit. First, PG&E added language underscoring what the plan already said, that PG&E would continue to honor its workers' compensation obligations. *See* ER 87, 93. Second, PG&E added language to confirm what was already true as a matter of law, that nothing in the plan would affect the subrogation rights of any surety of workers' compensation claims. ER 87-88, 91-94. Travelers has never asserted that,

absent this language, the plan would have purported to cut off Travelers' potential reimbursement and subrogation rights. ER 318.

Whenever that comfort language was inserted into any iteration of the plan or disclosure statement, it was coupled with a companion clause reserving PG&E's converse right to object to asserted subrogation rights. *See, e.g.*, ER 87 ("Nothing herein shall affect . . . the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of any such subrogation rights"); ER 88, 91, 93. While Travelers now asserts that PG&E added this language later, and thereby unilaterally modified the language the two had negotiated (*see* Pet. 8), the truth is that the very same language was contained in every iteration of the plan Travelers cites. ER 86-89, 90-94.

The final plan that the Bankruptcy Court ultimately confirmed, in 2003, included both PG&E's undertaking to continue honoring its workers' compensation obligations and the reciprocal language preserving both Travelers' subrogation rights and PG&E's right to oppose subrogation claims. *See* RJN Ex. 1.

One facet of the plan made it a rarity in the bankruptcy world: The final plan, like every proposed plan before it, provided for the full payment of all allowed claims, with interest. So this was one of the extraordinarily rare bankruptcies in which every creditor was paid 100 cents on the dollar (and then some).

D. Travelers Seeks Attorneys' Fees For Its Meritless Claim And Superfluous Comfort Provisions.

Shortly after signing the stipulation, Travelers proceeded to file an Amended Claim, demanding that PG&E cover the legal fees and other expenses it incurred in connection with its interventions in the bankruptcy proceeding. ER 175. The claim was not premised on any

right under the Bankruptcy Code, which would never provide attorneys' fees under these circumstances. *See Renfrow v. Draper*, 232 F.3d 688, 693 (9th Cir. 2000). Rather, Travelers invoked a provision of its indemnity agreements with PG&E. The agreements specified that PG&E would be obliged to pay attorneys' fees incurred in "recovering or attempting to recover any salvage in connection [with the surety bonds] or enforcing by litigation or otherwise any of the [indemnification] agreements." ER 41, 45; *see* Pet. 5 (quoting the provision more fully).

Travelers insisted that this provision gave it a right to reimbursement of the attorneys' fees it incurred to press and defend the Original Claim, which it abandoned by stipulation recognizing it was meritless. ER 170-72. Travelers also asserted that the contract obliged PG&E to pay the fees Travelers incurred agitating for comfort language, and quibbling over PG&E's reservation of the right to object to any subrogation claim. ER 277-79. Travelers insisted that PG&E unilaterally inserted the latter reservation, even though the very same language appeared in both the stipulation and every iteration of the plan. ER 278. The legal bill came to $167,000, nearly half of which Travelers attributed to litigating the concededly meritless claim. ER 186, 277-295.

PG&E objected to Travelers' attorneys' fees claim on several grounds, two of which are especially relevant here. The first was an issue of contract interpretation: Travelers had no right to attorneys' fees under the indemnity agreement, because its contingent claim and subsequent negotiations were not directed at "enforcing . . . any of the [indemnification] agreements." ER 45; *see* Pet. 5. Second, as a matter of bankruptcy law, recovery of attorneys' fees incurred with respect to purely bankruptcy law matters—as opposed to state law matters such as the terms, enforceability or breach of a contract—is not permissible.

When all was said and done, Travelers' intervention was the bankruptcy equivalent of a visit from Goldilocks: unwelcome, disruptive, costly and entirely gainless for all involved.

E. The Bankruptcy Court And District Court Reject Travelers' Demand For Attorneys' Fees.

The Bankruptcy Court disallowed the claim for attorneys' fees, merging elements of both of PG&E's arguments. Pet. App. 20a-21a, 23a-25a. The main focus was a long line of Ninth Circuit decisions—most notably, *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991)—holding that a creditor may not collect attorneys' fees incurred solely in litigating issues of federal bankruptcy law, as opposed to protecting rights under state law. Applying the *Fobian* rule, the court concluded that none of the attorneys' fees Travelers sought were incurred in protecting Travelers' state law rights; all were incurred in litigating issues relevant only to federal bankruptcy law. Pet. App. 24a; ER 321, 328, 371-74. The Bankruptcy Court also went out of its way to observe that Travelers had no basis for filing the Original Claim in the first place, noting that Travelers' capitulation spoke volumes about the merits of that claim. ER 328.

The Bankruptcy Court also touched upon the issue of contract interpretation. It found that neither PG&E's objections to the Original Claim nor PG&E's reorganization plans did anything to threaten Travelers' rights (*see* ER 328, 339, 351, 371-74), which is tantamount to a conclusion that Travelers was not thereby "enforcing" its rights under the indemnification agreements. Beyond that, the Bankruptcy Court observed that Travelers had no right "under any theory" to assert a claim against PG&E for attorneys' fees incurred in defending the meritless Original Claim. ER 321; *see* ER 328.

On appeal to the District Court, PG&E once again asserted both grounds for affirmance. Pet. App. 4a; ER 398. The District Court affirmed. Pet. App. 19a. While the District Court also focused mainly on the ground that creditors may not recover attorneys' fees incurred with respect to "matters [that] involve exclusively bankruptcy proceedings" (Pet. App. 17a), it too made findings that can only be understood as supporting PG&E's contract interpretation argument. The District Court noted, for example, that "the measures employed by Travelers cannot be considered 'an action on the contract[s]' or bonds." *Id.*

F. The Court Of Appeals Rejects The Attorneys' Fee Claim Based On Uncommon And Especially Unsympathetic Facts.

The Court of Appeals affirmed in an unpublished memorandum opinion with no precedential value. Pet. App. 1a n.*. The Court of Appeals echoed the analysis of the lower courts, emphasizing two points that were especially relevant to its holding. First, "[n]othing in the federal bankruptcy proceedings required Travelers to satisfy any of the obligations assured by, or to make any payments with respect to, any of its surety bonds or indemnity agreement with [PG&E]." Pet. App. 2a. Second, "Travelers did not prevail on any claim it asserted in the bankruptcy proceedings." *Id.* The Court of Appeals went out of its way to underscore the absurdity of awarding attorneys' fees when these two factual elements converged:

> [I]f unimpaired, non-prevailing creditors were authorized to obtain an attorney fee award in bankruptcy for inquiring about the status of unimpaired inchoate and contingent claims, the system would likely be overwhelmed by fee applications, with no funds available for

> disbursement to impaired creditors or debtor reorganization. (Pet. App. 3a)

Like the Bankruptcy Court and the District Court before it, the Court of Appeals, too, made observations that bore on PG&E's alternative contractual ground. It pointed out, for example, that "Travelers' objection to the reorganization plan . . . claimed only that the debtor failed to provide 'adequate information' about the reorganization plan" (Pet. App. 2a), which is a far cry from an effort to "enforc[e]" a contractual right.

REASONS TO DENY THE PETITION

This case is about an esoteric rule governing the award of attorneys' fees in bankruptcy cases in a limited set of circumstances. Specifically, this case is about one application of the rule to a rare scenario: where the creditor insinuates itself into a bankruptcy proceeding even though the debtor has not defaulted on the relevant obligations, and the creditor fails to secure itself any rights that it did not already have by operation of law. This Court should deny review for four reasons.

First, contrary to Travelers' insistence, there is no circuit conflict. On the narrow issue presented here, the Court of Appeals reached a conclusion that is not in conflict with any opinion from any court at any level. Travelers does not cite a single case that allows an unimpaired creditor like Travelers to recover attorneys' fees for pressing unsuccessful demands. *See* Part I(A), *infra*. Even on the slightly broader issue—the legitimacy of the Ninth Circuit's *Fobian* rule—there is no conflict. While Travelers asserts that nine different circuits are locked in a conflict that is "longstanding, widespread, [and] entrenched" (Pet. 3), none of the cases that supposedly illustrate the split mentions anything about a split or criticizes a sister circuit's holding with respect to the *Fobian* principles. Instead, Travelers

manufactures the circuit split by: (1) misstating the Ninth Circuit's rule; and (2) asserting that courts have "reject[ed]" the *Fobian* rule simply because they find it inapplicable to the facts before them. Pet. 2; *see* Part I(B), *infra*.

Second, as abstruse questions of bankruptcy law go, this one is about as unimportant as can be. The *Fobian* rule applies only in the narrow set of circumstances where a party presses issues that are purely a matter of federal bankruptcy law. Even within those circumstances, the rule has little impact on most creditors, whether because some are entitled to attorneys' fees by statute anyway or because fee awards are typically discounted drastically. *See* Part II, *infra*.

Third, fairly included within the question presented is a thorny issue of contract interpretation that has no import to anyone other than the parties in this case. PG&E has consistently argued, at every level, that it does not matter whether the *Fobian* rule applies to the peculiar circumstances presented here, because Travelers is not, in any event, entitled to fees under the indemnity agreements. If this Court grants certiorari, it will be treated to extensive briefing and argument on this inconsequential contract issue, and may well never reach the question Travelers is pressing. *See* Part III, *infra*.

Finally, the Court of Appeals was right, and its ruling is consistent with this Court's decisions. The various courts that follow the *Fobian* rule are not creating federal common law; they are interpreting the statute Congress wrote. *See* Part IV, *infra*.

I.

THIS CASE DOES NOT PRESENT A CIRCUIT CONFLICT EITHER ON THE NARROW ISSUE ACTUALLY DECIDED OR ON THE SLIGHTLY BROADER QUESTION TRAVELERS WISHES TO PRESENT.

Travelers urges this Court to take this case as a vehicle for addressing the validity of the *Fobian* rule, which it renders (inaccurately, as we shall see) as: "whether a litigant may recover attorneys' fees under a contract or state statute where the issues litigated involve matters of federal bankruptcy law." Pet. i. Travelers' primary basis for seeking certiorari is that nine circuits have split, 5-4, on this question. This position is doubly wrong. First, the question presented on the specific—seemingly unique—facts of this case is far narrower, and not subject to a split in authority at any level. Second, even on the slightly broader (though still narrow) question of the *Fobian* rule's validity, the circuits are not in conflict.

A. There Is No Circuit Split—Or Even Contrary Authority—On The Narrow Question Presented On These Facts.

While citing and discussing precedents decided on broader grounds, the Court of Appeals recognized that this case presents an exceedingly narrow version of the question it had confronted in past cases. As the Court of Appeals understood, the issue presented on the peculiar facts of this case is whether "*unimpaired, non-prevailing* creditors were authorized to obtain an attorney fee award in bankruptcy for inquiring about the status of *unimpaired inchoate and contingent claims*." Pet. App. 3a (emphasis added). It was relevant to the Court of Appeals—as undoubtedly it would be to this Court—that "[n]othing in the federal bankruptcy

proceedings required Travelers to satisfy any of the obligations assured by, or to make any payments with respect to, any of its surety bonds or indemnity agreement with [PG&E]," and that "Travelers did not prevail on any claim it asserted in the bankruptcy proceedings." Pet. App. 2a.

Travelers does not cite a single opinion from another circuit—or, indeed, from any court at any level—that awards attorneys' fees on these facts. There is no reported decision holding that a *non-prevailing* party is entitled to recover attorneys' fees incurred in litigating *purely bankruptcy matters* (rather than state law rights), where recovery is sought from a debtor *who has not defaulted* on any obligations owed to the creditor and the intervention was otherwise unnecessary. The most analogous case is from the Sixth Circuit, which circuit Travelers counts on the anti-*Fobian* side of the ledger, and that case, too, rejects the attorneys' fees claim. *See Capitol Indus., Inc. v. Regal Cinemas, Inc. (In re Regal Cinemas, Inc.)*, 393 F.3d 647 (6th Cir. 2004). Like this case—and unlike every other case Travelers cites as evidence of a conflict—*Regal Cinemas* involved a creditor who had no allowable claim, but nevertheless sought attorneys' fees, under a contract, for the effort it expended pursuing claims that were disallowed. *Id.* at 651. The Sixth Circuit rejected the claim for fees, concluding that the Code does not allow naked fees to be recovered shorn from effort to recover on an otherwise valid debt. *Id.*

The most Travelers can do is point to broad statements in other factual contexts, and posit that the various courts would apply those statements with equal force to this set of facts—if ever they were to encounter the same scenario. But Travelers offers no reason to believe that this factual scenario—which, so far as appears from published decisions, never presented itself in the past—is likely to arise with any greater frequency in the future. And Travelers offers no reason why this Court should rush to address the scenario

now, rather than letting the issue percolate and waiting to see whether a conflict materializes.

B. There Is No Circuit Split Even On The Broadest Application Of The *Fobian* Rule

Even ignoring the specific factual context presented here, and pretending this case presents the broadest possible application of the *Fobian* rule, this case still presents no circuit split.

If, as Travelers asserts, there were a "conflict among the courts of appeals [that] is longstanding, widespread, [and] entrenched" (Pet. 3), and if nine circuits have lined up on either side of a great legal schism (*see* Pet. 15), surely several of them would have called attention to the conflict. Or at least one of them would have. Not a single one of the cases Travelers invokes—on either side of the supposed divide—identifies a conflict over the *Fobian* principles.

It is not that the circuits are being uncharacteristically coy about their disagreements, or putting on a façade to spare the lower courts. The explanation is that the courts of appeals across the nation are applying essentially the same rules. That is obviously true of the four circuits that have explicitly adopted the *Fobian* rule. *See* Pet. 13 (citing cases from the Second, Seventh and Tenth Circuits). But it is also true of the five circuits Travelers places on the other side of the secret divide, even if they do not expressly announce, "We hereby embrace *Fobian*."

Uniformly, the supposedly contrary cases start, as the Ninth Circuit does, with the premise that "[t]here is no general right to attorney's fees under the Bankruptcy Code." *Renfrow*, 232 F.3d at 693 (citations omitted); *see, e.g.*, *Jordan v. Southeast Nat'l Bank (In re Jordan)*, 927 F.2d 221, 226-27 (5th Cir. 1991) ("the Bankruptcy Code does not does not expressly award attorney's fees to a creditor who successfully contests the dischargeability of his claim"),

overruled on other grounds by In re Coston, 991 F.2d 257 (5th Cir. 1993) (per curiam). They generally agree that nevertheless "a prevailing party in a bankruptcy proceeding may be entitled to an award of attorney fees in accordance with applicable state law if state law governs the substantive issues raised in the proceedings." *Ford v. Baroff (In re Baroff)*, 105 F.3d 439, 441 (9th Cir. 1997); *see, e.g., TranSouth Fin. Corp. v. Johnson*, 931 F.2d 1505, 1507 (11th Cir. 1991) ("attorney's fees are properly awarded to a creditor prevailing in a bankruptcy claim if there exists a statute or valid contract providing therefor").

To be sure, in close cases, different courts might give different answers to the question whether "state law governs the substantive issues." *Compare In re Sheridan*, 105 F.3d 1164, 1167 (7th Cir. 1997) (state reciprocity statute held inapplicable to specific facts presented) *with Cadle Co. v. Martinez (In re Martinez)*, 416 F.3d 1286, 1290 (11th Cir. 2005) (rejecting the *Sheridan* holding on similar facts without disagreeing with the fundamental approach dictated by *Fobian*). For example, several of the circuits appear to agree that battles over whether a debt should be discharged—which means that the debt is cancelled when the bankruptcy case is over (*see* 11 U.S.C. §523(a))—is a dispute "on the contract," for which attorneys' fees are available. *See, e.g., Alport v. Ritter (In re Alport)*, 144 F.3d 1163, 1168 (8th Cir. 1998); *Davidson v. Davidson (In re Davidson)*, 947 F.2d 1294, 1298 (5th Cir. 1991); *TranSouth*, 931 F.2d at 1508-09; *Jordan*, 927 F.2d at 226-27; *Martin v. Bank of Germantown (In re Martin)*, 761 F.2d 1163, 1168 (6th Cir. 1985). While there is a sense in which "bankruptcy discharge [is] . . . plainly an issue of bankruptcy law" (Pet. 13), those courts generally reason that this issue involves enforcement of the contract, because the dischargeability question essentially is a fight about the prospect of the creditor being fully paid on the contractual obligation. *See, e.g., Martin*, 761 F.2d at 1168. The Ninth Circuit, on the

other hand, has held that attorneys' fees can be awarded for some discharge skirmishes and not others. *Compare Am. Express Travel Related Servs. Co. v. Hashemi (In re Hashemi)*, 104 F.3d 1122, 1126-27 (9th Cir. 1996) (declining to award attorney's fees incurred in objecting to debtor's discharge *on bankruptcy law grounds*) *with Renfrow*, 232 F.3d at 695 (creditor that successfully objected to discharge in connection with establishing the validity of underlying debt—a state law issue—was awarded a portion of attorneys' fees incurred), *and Baroff*, 105 F.3d at 443 (debtor was entitled to attorneys' fees incurred in successfully defending objection to discharge because bankruptcy court decided the proceeding on a threshold state law issue—that the creditors did not have valid claims by virtue of a pre-petition release). In the unlikely event it is worth this Court's energy to sort through these differential outcomes, the Court is free to do so in a future case that presents the conflict. But since this case does not arise out of the discharge context, the Court's intervention here will do nothing to address that possible discrepancy.

In an effort to demonstrate a conflict over the *Fobian* rule, Travelers invokes seven Bankruptcy Code cases from five circuits (beyond the four circuits that explicitly embrace the rule). *See* Pet. 2, 13.[3] Travelers manufactures the appearance of conflict through two devices. First, Travelers consistently mischaracterizes the Ninth Circuit rule. The distortion of the rule starts at the very inception of Travelers' Petition—indeed, in the question presented, itself. Travelers describes it as a rule that forbids "a litigant [to] recover attorneys' fees under a contract or statute where the issues

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[3]An eighth case, which is omitted from Travelers' first list (*see* Pet. 2), but materializes in the second iteration, was decided under the former Bankruptcy Act, which Congress repealed twenty-seven years ago—and is otherwise distinguishable for many of the reasons discussed below. *See* Pet. 13 (citing *Worthen Bank & Trust Co., N.A. v. Morris (In re Morris)*, 602 F.2d 826 (8th Cir. 1979)).

litigated *involve* matters of federal bankruptcy law." Pet. i (emphasis added); *see also* Pet. 11, 20. If that were the Ninth Circuit rule, it *would* be in conflict with the rest of the circuits. As Travelers amply demonstrates, there are plenty of circumstances where a creditor can be awarded attorneys' fees even though the "litigated issues [did] *involve* . . . federal bankruptcy law." *See* Pet. 12-15 (emphasis added). The litigation is taking place, after all, in *bankruptcy* court.

But that is not the rule in the Ninth Circuit—or anywhere else in the country. *See Renfrow*, 232 F.3d at 695. The question under the *Fobian* rule is not whether the bankruptcy law is "involve[d]," but whether (as noted above) the issues being litigated "involved *solely* issues of federal bankruptcy law" (Pet. App. 16a (emphasis added)), and whether they are "uniquely" and "exclusively" bankruptcy matters (Pet. App. 17a). It, therefore, does Travelers no good to contrast the purported Ninth Circuit rule with seven cases that "follow the [alternative] rule that creditors may recover fees incurred in litigating federal bankruptcy issues." Pet. 13. Put that way, the Ninth Circuit follows the alternative rule, too. *See, e.g.*, *Renfrow*, 232 F.3d at 695 (creditor that successfully objected to discharge, *under bankruptcy law*, was awarded portion of attorneys' fees incurred in connection with establishing the validity of underlying debt); *Baroff*, 105 F.3d at 443 (debtor was entitled to attorneys' fees incurred in successfully defending objection to discharge, *under bankruptcy law*, because bankruptcy court decided the proceeding on a threshold state law issue, namely, that the creditors did not have valid claims by virtue of a pre-petition release).

Similarly, Travelers insists that the Ninth Circuit has adopted the principle that "the parties' contractual allocation of liability for attorneys' fees is invalid unless *authorized* by federal law" (Pet. 15 (emphasis in original))—that it simply does not matter what the contract says. That is not the standard that the Ninth Circuit has articulated. It is not at all

clear that the Ninth Circuit has adopted any such hard and fast rule. The Ninth Circuit's typical articulation of the rule is: "Because state law necessarily controls an action on a contract, a party to such an action is entitled to an award of fees *if the contract provides for an award and state law authorizes fee shifting agreements.*" *Baroff*, 105 F.3d at 441 (emphasis added). The italicized words indicate that the touchstone for the Ninth Circuit is the contract itself. The *Fobian* rule applies only if "the substantive litigation raise[s] federal bankruptcy law issues *rather than* 'basic contract enforcement questions.'" *Id.* (citing *Fobian*, 951 F.2d at 1153) (emphasis added). When the Ninth Circuit says the *Fobian* rule applies only where the intervention "involve[s] *solely* issues of federal bankruptcy law," it evidently means that "[t]he question of the applicability of the bankruptcy laws to particular contracts *is not a question of the enforceability of a contract* but rather involves a unique, separate area of federal law." *Fobian*, 951 F.2d at 1153 (emphasis added; internal quotation marks omitted); *see Hashemi*, 104 F.3d at 1126 (same).

Based at least upon what the Ninth Circuit *says* it is doing in these cases, the language of the contract (or the provision of state law) is quite relevant in determining whether attorneys' fees will be awarded. The Ninth Circuit consistently focuses on whether or not the creditor's intervention is an "action on a contract," which is to say an action to "enforce" a contract. *See Fobian*, 951 F.2d at 1153 ("This was not a traditional 'action on the contract'"); *see also Renfrow*, 232 F.3d at 693 ("'state law necessarily controls an *action on a contract*'") (quoting *Baroff*, 105 F.3d 439 at 441) (emphasis added and omitted); *Hashemi*, 104 F.3d at 1126-27 (attorneys' fees are not recoverable because this was "not an *action on the contract*") (emphasis added). Likewise several of the circuits that Travelers puts in the *Fobian* camp explicitly consider contract or statutory language even with respect to purely bankruptcy matters.

See Burns v. Great Lakes Higher Educ. Corp. (In re Burns), 3 F. App'x 689, 691 (10th Cir. 2001) (unpublished) ("Oklahoma has strictly construed [the state statute]. Therefore, [the statute] does not apply here") (citation omitted); *Sheridan*, 105 F.3d at 1167 ("this federal action does not qualify as one 'with respect to the contract' under the Florida statute"). Admittedly, in one Ninth Circuit case (involving a statute, not a contract), the Ninth Circuit has spoken more expansively. *See DeRoche v. Arizona Indus. Comm'n (In re DeRoche)*, 434 F.3d 1188, 1192 (9th Cir. 2006) (stating that the "character of the particular state statute is irrelevant"); *see also Hassen Imports P'ship v. KWP Fin. VI (In re Hassen Imports P'ship)*, 256 B.R. 916, 923 (B.A.P. 9th Cir. 2000). But the most this imprecise language does is to raise doubts about exactly what the Ninth Circuit rule is—questions that the Ninth Circuit is best situated to resolve free from this Court's editorial input.

The second device Travelers uses to manufacture the appearance of circuit conflict is to invoke cases that *distinguish* the prevailing rule but to mischaracterize them as "rejecting *Fobian*." Pet. 2. The best example is *Three Sisters Partners, L.L.C. v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843 (4th Cir. 1999), which Travelers features at length as the poster child for circuit conflict. *See* Pet. 14. Contrary to Travelers' claim, the case did not reject *Fobian*'s holding; it rejected *Fobian*'s relevance—both because the specific statutory provision in question called for a different analysis and because the ultimate issue being litigated was an issue of contract interpretation. *See* 167 F.3d at 848.

Shangra-La arose in the context of a debtor's decision to ratify (or "assume," in bankruptcy parlance) a commercial lease agreement as tenant, exercising a specific statutory right—under Section 365 of the Bankruptcy Code—to hold the landlord to its obligations under the terms of the lease. *See* 11 U.S.C. §365. The same provision that grants the right, imposes limitations. In order to assume the lease, the

debtor must (1) cure certain defaults under the lease; and (2) compensate the landlord for "actual pecuniary loss[es]" *resulting from those defaults*. 11 U.S.C. §365(b)(1)(A) & (B).

This statutory rule played a central role in that case. The lease agreement had a fee-shifting provision, and the question before the court was whether the landlord's compensable "pecuniary loss[es]" under Section 365 could include attorneys' fees. The court's answer was that attorneys' fees *might* be compensable, but only to the extent that the fees "were expended as the result of a default under the . . . lease . . . and are recoverable under the [lease] and applicable state law." *Shangra-La*, 167 F.3d at 849 (citations omitted). Significantly, the court remanded the case with instructions to award attorneys' fees *only* to that extent. *Id.* at 849-50 ("[Section] 365(b)(1)(B) does not create an *independent* right to an award of attorneys' fees") (emphasis added). It left it to the lower court to determine whether the creditor could recover fees in connection with its effort to seek relief from the automatic stay and to object to the assumption of the lease, which are more clearly matters of pure bankruptcy law. *Id.* at 850.

In reaching this conclusion, the Fourth Circuit did not "reject[]" the Ninth Circuit's *Fobian* rule wholesale, as Travelers asserts. Pet. 14. It is true, as Travelers emphasizes, that the Fourth Circuit said that this formulation "inappropriately focuses on the presence of issues peculiar to bankruptcy law." *Id.* (quoting *Shangra-La*, 167 F.3d at 848). But, as is evident from the next sentence (which Travelers omits), what that meant was that "the state law/bankruptcy law dichotomy relied upon by the bankruptcy court cannot serve to solve the puzzle of a landlord's right to post-petition attorneys' fees *under [Section] 365(b)(1)(B) of the Bankruptcy Code*." 167 F.3d at 848 (emphasis added). The court was indicating only that the standard could not be transported uncritically from one context to another. The

court explained, by "ordering that default be cured . . . and that pecuniary losses be paid . . . , [Section 365] sends us back to state *contract law* for a determination of the terms of default and the landlord's rights upon default under the lease." *Id.* at 848 (emphasis added). Far from indicating a circuit split, the Fourth Circuit reached a conclusion that is consistent with current Ninth Circuit law, for the Ninth Circuit itself has recognized that the *Fobian* rule is inapplicable in the face of a Bankruptcy Code provision that specifically incorporates state law. *See Kord Enters. II v. California Commerce Bank (In re Kord Enters. II)*, 139 F.3d 684, 687 (9th Cir. 1998) (relying on the plain language of Bankruptcy Code Section 506(b) to hold that—despite the *Fobian* rule—a creditor holding a security interest in collateral that is worth more than the amount of the underlying claim is entitled to attorneys' fees in accordance with the terms of its contract).[4]

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[4]Elsewhere, Travelers cryptically asserts—without further explanation—that an Eleventh Circuit case "reject[s] . . . [the] Ninth Circuit's *Fobian* analysis" and that an Eighth Circuit case "reject[s] *Fobian*." Pet. 2 (citing *Martinez*, 416 F.3d 1286, and *Alport*, 144 F.3d 1163). In fact, the first case merely distinguishes Ninth Circuit authority "under the facts and circumstances of this case." *Martinez*, 416 F.3d at 1290-91. And the second cites *Fobian* with approval for the basic rule that creditors *may* be entitled to an award of attorneys' fees in bankruptcy. *See Alport*, 144 F.3d at 1168.

II.

THE PRECISE CIRCUMSTANCES UNDER WHICH A SMALL CLASS OF CREDITORS CAN SIPHON ATTORNEYS' FEES FROM A BANKRUPTCY ESTATE IS NOT AN ISSUE OF NATIONAL IMPORTANCE.

The Bankruptcy Court was being generous when it said, "this is . . . a frankly obscure area of the law." Pet. App. 25a.

This case is not about whether a creditor may meddle in a bankruptcy proceeding, even though the debtor has not defaulted on any obligation owed to the creditor and is unlikely ever to do so. (It may.) This case is not about whether such a creditor has the latitude to waste the resources of other creditors and the bankruptcy court by filing claims, only to stipulate that they are meritless, or by insisting on line-editing plan language to reserve legal rights that are already reserved by operation of law. (It does.) This case is about whether the interloper has a right to force the bankruptcy estate—which is to say, all the creditors with legitimate claims—to cover the legal expenses it incurs in doing so. Assuming one could muster an argument that such a right exists and is desirable, there is no pressing national need to pronounce it as a nationwide norm.

Even expanding this case to the broadest level—to an inquiry into the validity of the *Fobian* rule in all potential applications—this case is exceedingly modest in scope and impact. The rule is not of interest to all creditors, nor even to all creditors that have contractual fee-shifting arrangements, but only to those creditors with contractual fee-shifting arrangements that are broad enough to cover any sort of participation in a bankruptcy proceeding. The rule is of no relevance to creditors who file claims because the debtor has defaulted on an obligation and incur legal fees in litigation

over the validity of the debt; if the debtor defaults, and the default is covered by a contractual fee-shifting provision, all circuits agree that the creditor can claim attorneys' fees. The rule has a potential impact only on creditors that are seeking reimbursement for activities that a court might deem "pure bankruptcy" matters.

The impact even on this narrow sliver of creditors is likely to be minimal. Within this sliver would be three basic classes of creditors: oversecured creditors (those whose debts are secured by collateral that is more valuable than the amount of the debt); undersecured creditors (those whose debts are secured by collateral whose value would not cover the amount of the debt); and unsecured creditors (the masses who hold no collateral). The *Fobian* rule has no relevance to oversecured creditors, because the Bankruptcy Code already "specifically grants attorneys' fees to oversecured creditors." *Kord Enters. II*, 139 F.3d at 687 (citing 11 U.S.C. §506(b)). The rule has little salience to undersecured creditors, who typically wield enough power and influence over the debtor (by virtue of their security interest in the debtor's property) that they can work out consensually any dispute over the appropriate amount of fees.

That leaves only the unsecured creditors within the sliver. For them, "[t]he bankruptcy court is a little like a soup kitchen, ladling out whatever is available in ratable portions to those standing in line." *XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.)*, 16 F.3d 1443, 1445 (6th Cir. 1994). Their primary concern is the debt they are clamoring to recover. That is far more important to the creditor than the (presumably much smaller) fee award they might stand to recover in connection with their efforts to collect the debt. Moreover, even a substantial fee award will almost always have diminished value, for these awards are reduced proportionately with the rest of the debt. A creditor who collects ten cents on the dollar for a debt will never

garner more than a tenth of the attorneys' fees that are awarded.

In light of these diminished stakes, contentious litigation over unsecured creditors' rights to collect attorneys' fees incurred during a bankruptcy case rarely materializes. Even in this case—with the uncommon feature of unsecured creditors who are paid 100 cents on the dollar—the cost of litigating Travelers' entitlement to attorneys' fees has already far outstripped the meager $167,000 at stake.

Finally, even if Travelers is correct that different circuits might reach different conclusions about fees in some narrow subset of cases, the differences are innocuous. No debtor would shop for a forum based upon the difference. And the outcome of bankruptcy proceedings for any particular creditor depends upon vicissitudes that are far more unpredictable and consequential than whether the *Fobian* rule controls attorneys' fees for some intervention or another.

III.

THIS CASE IS AN INAPPROPRIATE VEHICLE FOR ADDRESSING THE QUESTION TRAVELERS PRESENTS BECAUSE IT FAIRLY INCLUDES A THORNY, FACT-BOUND CONTRACTUAL ISSUE THAT COULD OBVIATE RESOLUTION OF THE LEGAL ISSUE PRESENTED.

The question Travelers presents rests on a false premise. Incorporated in the very first sentence is the premise that the indemnification agreements "included a provision that [Travelers] is entitled to recover its attorneys' fees in connection with . . . litigating its rights during the course of [PG&E's] bankruptcy case." Pet. i. Travelers has never contested that if this provision did not cover its

activities in the bankruptcy proceeding, then it would have no basis at all for demanding attorneys' fees.

At every step of the litigation, PG&E has maintained that the premise now built into Travelers' question presented is false: Travelers had no claim to attorneys' fees under the indemnification agreements. As Travelers indicates in its Petition, the operative language is the phrase promising attorneys' fees for "*enforcing by litigation or otherwise any of the [indemnification] agreements herein contained.*" Pet. 5 (emphasis in original) (quoting ER 41). PG&E has maintained throughout that Travelers was not "enforcing" the indemnification agreements when it intervened in the bankruptcy, because the agreements were neither breached nor in danger of being breached. It is a position that appeared to persuade the courts below, and PG&E will continue to press it here, should this Court grant certiorari.[5]

Thus, in the worst case scenario, this Court will have expended resources in plenary review of a purportedly important issue it ends up not deciding. In the best case, this Court will decide the issue Travelers has presented, but en route it will have wasted resources pondering knotty contractual issues that have no salience beyond this case.

IV.

THE COURT OF APPEALS' DECISION IS CORRECT.

Travelers does not question the legal underpinnings of the rule the Court of Appeals followed here. Travelers does

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[5]Travelers is free to assert the relevance of language in the indemnity agreements beyond the language it emphasizes. But that approach will simply multiply the number of inconsequential contract questions this Court will be entertaining: Was the bankruptcy intervention an "expense . . . by reason of executing [the] Bonds"? ER 41. Was the expense "incurred by reason of making any investigation on account thereof"? And so forth.

not dispute that "[i]t is the general rule in the United States that in the absence of legislation providing otherwise, litigants must pay their own attorney's fees." *Christiansburg Garment Co. v. EEOC*, 434 U.S. 412, 415 (1978). Nor does it dispute that while "[t]he Bankruptcy Code does contain some fee provisions[,] . . . it does not contain any provisions that create a general right for the prevailing party to be awarded attorney's fees in federal bankruptcy litigation." *DeRoche*, 434 F.3d at 1191 (citation omitted). And Travelers does not seem to challenge the axiom that "[w]hen a cause of action is federal, . . . we ordinarily do not look to state law in considering whether to award attorney's fees." *Sheridan*, 105 F.3d at 1167 (citing *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 259 n.31 (1975); *F.D. Rich Co. v. United States ex rel. Indus. Lumber Co.*, 417 U.S. 116, 127 (1974)).

Despite these undisputed propositions, Travelers insists on a right to claim attorneys' fees here, even though: PG&E never defaulted; Travelers' financial position was unimpaired by the bankruptcy filing; Travelers admitted the claim it filed was meritless; it did not prevail on any point it pressed in the bankruptcy proceeding; the only positions it pressed related to matters that had no bearing on its future rights; and its interventions arose purely as a matter of federal bankruptcy law. Travelers does not point to any provision of the Bankruptcy Code that grants attorneys' fees to anyone who wishes to meddle in bankruptcy proceedings to press meritless claims and negotiate changes that serve only to waste resources—an omission that is especially telling because when Congress has wanted to award attorneys' fees to particular creditors, it has done so explicitly. *See* 11 U.S.C. §506(b). Nor does Travelers point to any case from this Court that promotes such a counterintuitive and wasteful rule of law.

Instead, Travelers relies mainly on *Security Mortgage Co. v. Powers*, 278 U.S. 149 (1928), which this Court

decided more than seventy-five years ago under the long-since repealed 1898 Bankruptcy Act. *See* Pet. 3, 13, 15. True, the creditor in that case sought attorneys' fees. But that is where the similarity ends, for the creditor there could scarcely have been situated more differently from Travelers. The case involved an oversecured creditor (one with collateral more valuable than the amount of the debt) not a completely unsecured creditor like Travelers (with no collateral). *Security Mortgage*, 278 U.S. at 151. Unlike PG&E here, the debtor there had defaulted on an obligation. *Id.* at 152. In fact the attorneys' fees the creditor sought to collect were incurred in connection with a proceeding in which the creditor prevailed in state court under state law—not, as here, in connection with an intervention, untethered to any actual debt, pressing purely bankruptcy issues in bankruptcy court. *Id.* And the attorneys' fees were due by virtue of a state statute that specifically awarded fees in connection with that state court collection action. *Id.* at 152-53. It was only in this context that the Court held that certain portions of the attorneys' fees obligation that arose under state law could be recovered in bankruptcy as part of the underlying debt.

Although Travelers does not assert that this case is factually similar, it argues that the obligation supposedly created by contract in this case should be treated like the debt created by the state statute in that case. Travelers' position seems to be that *if* the indemnity agreements actually did require PG&E to cover legal fees in connection with any conceivable bankruptcy intervention Travelers might undertake, no matter how frivolous, *then* federal bankruptcy law does not stand in the way.[6] Both the factual premise and the legal conclusion are wrong.

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[6]No doubt, Travelers hopes to renew before this Court its arguments—rejected by three courts—that its Original Claim was not meritless and its interventions did advance its interests. But Travelers

(continued . . .)

As a matter of fact, as we have seen (and as the courts below evidently believed), the indemnification agreements were more modest in coverage. *See* pp.7-9, *supra*. So the argument fails at the premise.

As to the legal conclusion, let us assume that the Court of Appeals opinion here could be read as a holding that federal law would trump a contractual provision that expressly reallocated attorneys' fees under these circumstances, a reading, as we have seen, that is not at all obvious. *See* pp.16-19, *supra*. Even if that were obviously the Ninth Circuit's rule, such a rule would be perfectly consistent with this Court's jurisprudence. It is one thing to say that a bankruptcy court must recognize the obligation to cover attorneys' fees when that obligation arises out of state statutes or contracts that are directed at compensating a creditor for efforts necessary to collect on an underlying debt. But this Court has never suggested, much less held, that private parties can turn a bankruptcy proceeding into a feeding frenzy for the officious, not only encouraging them to file frivolous claims and seek accommodations that serve no one's interests, but compensating them for doing so—at the expense of other creditors. Surely a bankruptcy court would not be expected to follow a state statute that declared: "Bankruptcy creditors who incur legal fees in connection with any bankruptcy intervention whatever shall be entitled to collect those fees from the debtor." *See Kord Enters. II*, 139 F.3d at 687; *In re Vinson*, 337 B.R. 147, 149-50 (Bankr. E.D. Mich. 2006), *rev'd on other grounds*, No. 06-10478, 2006 WL 1662838 (E.D. Mich 2006). By the same token, a bankruptcy court should not enforce a contract that achieves the same result under state law for one creditor. *See*

(. . . continued)
has not presented those fact-bound issues for review, and even if it did, they are unworthy of this Court's attention. So Travelers is stuck defending the legal rule as applied to the facts found.

Norfolk & W. Ry. Co. v. Am. Train Dispatchers' Ass'n, 499 U.S. 117, 129-30 (1991) (contracts can be preempted, if Congress so intended); *Fallick v. Kehr*, 369 F.2d 899, 904 (2d Cir. 1966) ("[A]n advance agreement to waive the benefits of the Act would be void"); *Hassen Imports*, 256 B.R. at 923; *Knepp v. Credit Acceptance Corp. (In re Knepp)*, 229 B.R. 821, 842 (Bankr. N.D. Ala. 1999) ("Courts have long held that a pre-dispute agreement to waive benefits conferred by the bankruptcy laws is wholly void as against public policy").

Thus, if the *Fobian* rule were indeed read to override contractual language in this context, it is not a "new federal common law rule of decision." Pet. 18. As Travelers acknowledges, none of the courts of appeals embracing the *Fobian* rule so much as mention federal common law. Pet. 19. Rather, if *Fobian* does override contracts, it is because the courts are applying ordinary principles of statutory construction to conclude that Congress did not intend to allow private parties to adjust the rule barring the award of attorneys' fees in connection with the enforcement of rights or obligations created purely as a matter of federal bankruptcy law.

Equally meritless is Travelers' contention that "[t]he *Fobian* line of cases conflicts with this Court's precedents restricting the ability of federal courts to establish categorically how claims are to be treated under the Bankruptcy Code." Pet. 19. As an initial matter, there is no prohibition against categorical rules—particularly when it comes to what claims are allowed or disallowed, which is, by statute, determined almost entirely in categorical terms.[7] The

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[7] *See, e.g.*, 11 U.S.C. §502(b)(2) (disallowing claims for unmatured interest); *id.* §502(b)(3) (disallowing claims for taxes assessed against estate property exceeding the value of the estate's property interest); *id.* §502(b)(6) (disallowing lease rejection claims exceeding certain threshold); *id.* §502(b)(7) (disallowing employment contract termination claims exceeding certain threshold).

cases Travelers cites for the supposed categorical prohibition against categorical rules impose no such constraint. *See* Pet. 19-20. These cases merely hold that when the Bankruptcy Code calls for an equitable determination to be applied case by case, categorical rules are impermissible. *See United States v. Noland*, 517 U.S. 535, 540-41 (1996) (equitable subordination of certain tax penalty claims under 11 U.S.C. §510(c)); *United States v. Reorganized CF&I Fabricators, Inc.*, 518 U.S. 213, 228-29 (1996) (same). In any event, the *Fobian* rule is not a categorical rule. Under at least one reading of the cases, the rule depends on a close reading of the contract's terms. *See* pp.17-18, *supra*. But under any reading, the rule requires the court to analyze attorneys' fee claims case by case, as the lower courts clearly did in this case, to determine whether "the substantive litigation raise[s] federal bankruptcy law issues rather than 'basic contract enforcement questions.'" *Baroff*, 105 F.3d at 441 (citing *Fobian*, 951 F.2d at 1153).

CONCLUSION

The Petition for Writ of Certiorari should be denied.

DATED: July 7, 2006.

Respectfully submitted,

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No. 05-1429

IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF

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REPLY BRIEF FOR PETITIONER

Adhering to its prior precedent, the Ninth Circuit disposed of Travelers' claim for attorneys' fees through the application of a single rule of law that it first created over a decade ago: "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'" Pet. App. 3a (quoting *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991)). The Ninth Circuit neither addressed nor resolved any other issue in disposing of Travelers' claim and, accordingly, no other issue is presented to this Court for review.

In its petition, Travelers demonstrated that three other courts of appeals apply the *Fobian* rule and deny claims for attorneys' fees incurred in litigating bankruptcy issues, and that five other courts of appeals follow a contrary rule and allow such claims. This conflict is immediately apparent from the *holdings* of the decisions of these courts, as well as by analysis of their reasoning. In its opposition, Respondent PG&E says nothing at all about the conflicting holdings of the courts of appeals on the question presented. Instead, PG&E -- inartfully and unsuccessfully -- attempts to evade the issue by interposing a series of irrelevant distractions. Because a longstanding, entrenched, and widespread conflict exists among the courts of appeals on the question presented in this case, certiorari is warranted.

Travelers also demonstrated in its petition that the decision of the court below conflicts with prior precedents of this Court. First, it conflicts with this Court's prior precedents holding that the question whether a creditor is entitled by contract or statute to recover attorneys' fees for litigating issues in bankruptcy is a matter of state law. Second, it conflicts with prior precedents of this Court restricting the ability of federal courts to create federal common law rules that preempt state law rights. Third, it conflicts with this Court's prior precedents restricting the ability of federal courts to create categorical restrictions on claims in bankruptcy cases. PG&E offers nothing in response. Because the decision of the court below conflicts with prior precedents of this Court, certiorari is warranted.

Contrary to PG&E's contentions, the question presented is important and hardly arcane. The Ninth Circuit has applied its *Fobian* rule repeatedly, as have three other courts of appeals. In contrast, five courts of appeals apply a contrary rule, creating discord in the administration of bankruptcy proceedings on a national basis. This case presents an ideal vehicle to resolve the conflict because the Ninth Circuit resolved Travelers' claim purely as a matter of law through application of its *Fobian* rule. Moreover, this Court would not be required, as PG&E suggests, to consider any other issue (including any purported dispute over the interpretation of Travelers' contract) because the court below neither addressed nor resolved any other issue. *See Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 168-69 (2004) ("'We ordinarily do not decide in the first instance issues not decided below.'") (quoting *Adarand Constr., Inc. v. Minetta*, 534 U.S. 103, 109 (2001)).

Finally, the decision of the Ninth Circuit in this case is simply wrong, and Travelers is entitled to its fees incurred in, among other things, defending against PG&E's aggressive and unnecessary litigation. PG&E's various contentions to the effect that Travelers was "unsuccessful," holds a "meritless" claim, and "meddled" in PG&E bankruptcy case, are unfounded. After bringing suit against Travelers, PG&E executed a settlement agreement with Travelers that successfully preserved the substance of Travelers' rights and claims, *and in that very same settlement agreement* acknowledged that Travelers could assert a claim for its attorneys' fees under its contract (subject to PG&E's right to object to Travelers' fee claim). Each of the courts below denied Travelers' claim *only* as a matter of law on the basis of the *Fobian* rule. Because the *Fobian* rule is invalid, this Court should grant certiorari and reverse the decision below.

A. The Courts Of Appeals Are Divided Over The Question Presented.

In the companion case *DeRoche v. Arizona Indus. Comm'n*, no. 05-1439, respondent State of Arizona candidly concedes that the courts of appeals are deeply divided on the question whether a litigant may recover attorneys' fees under a contract where the

issues litigated involve matters of federal bankruptcy law. *DeRoche* Pet. Opp. 11. In discussing this split, the State accurately summarizes the *holdings* of the decisions of the courts of appeals that have allowed attorneys' fees, in conflict with the decisions of the Ninth Circuit, and cites to the leading treatise on bankruptcy law that explains and analyzes the conflict. Pet. Op. 11-12.

In the instant case, respondent PG&E does not refute Travelers' demonstration of the existence of a circuit split on the question presented. Instead, it argues -- disingenuously, based upon completely irrelevant reasons -- that no conflict among the courts of appeals exists. These arguments are unavailing.

First, PG&E asserts that the kind of contract at issue in this case (a surety's indemnity contract) is not precisely the same as the kind of contract at issue in the other cases (e.g., a landlord's indemnity contract). PG&E does not explain, however, why this difference is relevant; nor could it, as no reason exists. PG&E does not deny that, in *Fobian*, the Ninth Circuit created a rule of general federal common law that a litigant may not recover attorneys' fees under a contract where the issues litigated involve matters of federal bankruptcy law. PG&E also does not deny that the Ninth Circuit has repeatedly applied its *Fobian* rule to cover all kinds of contractual rights to attorneys' fees. Far from unique, this case is typical of what has become the Ninth Circuit's routine application of its *Fobian* rule. That Travelers is a surety, or that its contract is a surety contract, is of no moment.

Second, PG&E argues that Travelers is not entitled to prevail for "unique" reasons peculiar to the facts of this case. Specifically, PG&E contends that notwithstanding that it reneged on its negotiated deal with Travelers regarding the treatment of Travelers' rights, and then affirmatively *sued* Travelers in the bankruptcy court to eliminate Travelers' rights as a surety, Travelers' $100 million bond and associated rights were never in jeopardy during PG&E's bankruptcy case and that Travelers' claim for attorneys' fees is therefore unreasonable. PG&E also argues that its own assertions concerning Travelers' status in the bankruptcy proceedings and the reasonableness of the fee amount distinguish the Ninth Circuit's decision in this case from the

decisions of other courts of appeals. This is nonsense. None of the courts below based their denial of Travelers' claim for attorneys' fees on these grounds. To the contrary, each of the courts below simply applied the *Fobian* rule that, as a matter of law, a litigant is not entitled to recover attorneys' fees if the issues litigated involve questions of federal bankruptcy law. Accordingly, PG&E's assertions are irrelevant to the holding of the courts below, and to the conflict among the courts of appeals.

Third, PG&E attempts to disguise the conflict among the courts of appeals by simply ignoring the actual disagreement over the question presented and focusing on a series of irrelevant issues. To begin with, the fact that courts typically agree that there is no general right to attorneys' fees, Pet. Op. 14, is beside the point. The question is what is to be done with a right to attorneys' fees that arises under a contract or statute.

That courts typically agree that a litigant may recover a contractual or statutory right to attorneys' fees incurred in litigating *state* law issues, Pet. Op. 15, also is beside the point. The question presented -- and the point of the *Fobian* rule -- is what is to be done with attorneys' fees incurred in litigating *federal* bankruptcy issues.

That courts may disagree on whether a particular dispute over a debtor's discharge is encompassed within the scope of a litigant's contractual right to attorneys' fees, Pet. Op. 15, is equally beside the point. The question presented -- and the subject of the circuit split set forth in Travelers' petition -- is whether the *Fobian* rule is valid or invalid. That courts may further disagree on the application of the *Fobian* rule in the discharge context does not eliminate the larger split on the essential legitimacy of the *Fobian* rule itself.

Furthermore, while it may be difficult, for purposes of calculating and awarding fees, to distinguish between the litigation of state and federal issues in some cases because the issues may be intertwined, Pet. Op. 18, this suggests only that the *Fobian* rule is complex and cumbersome. Again, this difficulty does not render nonexistent the conflict among the courts of appeals on the legitimacy of the *Fobian* rule. Nor is the observation relevant in

this case, as the Ninth Circuit denied the *entire amount* of Travelers' fees on the ground that *all* the issues litigated were federal bankruptcy issues.

Contrary to PG&E's contention that Travelers has mischaracterized the *Fobian* rule, Pet. Op. 16, Travelers has simply presented the rule as the Ninth Circuit had stated and applied it. In this case, the Ninth Circuit, quoting *Fobian*, stated the rule as follows: "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'" Pet. App. 3a (quoting *Fobian*). And as PG&E *concedes*, Pet. Op. 17, other courts of appeals allow the recovery of attorneys' fees for litigating bankruptcy issues. Thus, comparing the Ninth Circuit's statement of its own rule with PG&E's concession is itself sufficient to demonstrate the conflict among the courts of appeals concerning the question presented. The "problem" is not Travelers' characterization of the *Fobian* rule but PG&E's disingenuous efforts to evade the existence of the conflict.

Finally, contrary to PG&E's assertion, Pet. Op. 19, Travelers has not mischaracterized the cases that reject the *Fobian* rule. For example, PG&E argues that the Fourth Circuit's decision in *Three Sisters Partners LLC v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843 (4th Cir. 1999) demonstrates *uniformity* among the courts of appeals. PG&E is wrong. The very proposition that PG&E contends *Shangra-La* stands for actually demonstrates the divergence of opinion among the courts of appeals and the need for guidance from this Court.

In *Shangra-La*, the debtor had defaulted on a commercial real estate lease prior to filing for bankruptcy. 167 F.3d at 845-46. The lease provided that the landlord could collect legal fees incurred in enforcing the lease, under certain circumstances. *Id.* After the debtor filed for bankruptcy, the landlord "actively participated in the case." *Id.* at 846. The landlord objected to relief sought by the debtor's trustee under the bankruptcy code, objected to plans of reorganization proposed by others, and even filed its own proposed plan of reorganization for the debtor's business. *Id.* at 846-47. The landlord also objected to motions seeking to extend the time for the debtor to assume or reject its lease under a specific

provision of the Bankruptcy Code, and sought relief from the automatic stay provided to the debtor by the bankruptcy code. *Id.*

Eventually, the debtor's trustee "assumed" the lease, and was required to cure all defaults. 167 F.3d at 847. As a result, the landlord sought reimbursement of its legal fees involved in its pre and post-petition litigation with the debtor. *Id.* The bankruptcy court allowed the landlord to recover its pre-petition fees, but denied the request for post-petition fees because such fees were incurred "litigat[ing] issues particular to bankruptcy law." *Id.*

On appeal, the Fourth Circuit reversed and remanded. 167 F.3d at 852. The court focused on the bankruptcy court's denial of fees relating to bankruptcy-specific matters, such as the landlord's "participation in the plan confirmation process," and attempts to obtain relief from the automatic stay. *Id.* at 848. The court concluded that the simple question whether bankruptcy issues were involved was irrelevant, *id.*, and that what was relevant was whether the fees incurred during the bankruptcy case were within the scope of the underlying contract (there, the lease), *id.* at 850.

Here, the Ninth Circuit came to the exact opposite conclusion: if bankruptcy issues are involved, the terms of the underlying contract are irrelevant. Pet. App. 9a, 25a. The differences between the approach taken by the Fourth Circuit in *Shangra-La* and by the Ninth Circuit in this case demonstrate the presence of a clear conflict among the courts of appeals. The rule applied by the Fourth Circuit employs the proper analysis and focuses on the underlying state law contract rights agreed upon by the parties. The rule of law applied by the Ninth Circuit, on the other hand, is an impermissibly created and inappropriate federal common law rule.

The decisions of the courts of appeals clearly conflict on the question presented. Accordingly, certiorari is warranted.

B. The Decision Below Conflicts With Prior Precedents Of This Court.

As explained in the petition, Travelers right to attorneys' fees falls within the broad scope of its indemnity agreements and is valid under California law. Under section 101 of the Bankruptcy

Code, a contractual right to attorneys' fees that is valid under state law unquestionably constitutes a "claim" for bankruptcy purposes, irrespective of whether the claimant incurred the fees before or after the debtor commenced its bankruptcy case. 11 U.S.C. § 101(5); *Cohen v. De La Cruz*, 523 U.S. 213, 228 (1998). In turn, under section 502(b) of the Code, a valid state law claim must be allowed in the debtor's case unless a specific provision of the Code disallows it. 11 U.S.C. § 502(b); *Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 20 (1990). Because no provision of the Bankruptcy Code disallows a contractual claim for attorneys' fees on the ground that the fees were incurred in litigating federal issues -- and given that federal courts lack the authority to create novel rules governing the categorical treatment of claims in bankruptcy, *see United States v. Noland*, 517 U.S. 535, 540 (1996) -- claims for attorneys' fees must be allowed if valid under state law. Accordingly, the Ninth Circuit's *Fobian* rule, relied upon in the decision below (as well as in the decisions of other circuit courts of appeals), is in error. Under the correct analysis, the question is not whether federal law authorizes the claim, but rather whether bankruptcy law extinguishes the state law right by disallowing the claim, which it does not in this instance. *Security Mortgage Co. v. Powers*, 278 U.S. 149, 154 (1928).

In response to Travelers' demonstration that the decision of the Ninth Circuit in this case conflicts with this framework and prior precedents of this Court, PG&E has essentially nothing to say. It does not refute that Travelers' contractual right to attorneys' fees constitutes a "claim" for bankruptcy purposes; nor does it dispute Travelers' explication of how "claims" are to be treated in bankruptcy. Further, PG&E does not contend that any provision of the Bankruptcy Code disallows Travelers' claim for attorneys' fees. Instead, PG&E merely assumes that courts should have the power to deny claims for attorneys' fees, but never bothers to explain where this authority comes from.

In an effort to obscure the issue, PG&E again recites a litany of criticisms against Travelers. These criticisms are both completely irrelevant and meritless. Travelers never "stipulated" or "admitted" that the claim it filed in PG&E's bankruptcy case was

meritless, as PG&E contends. Pet. Op. 26. Precisely to the contrary, Travelers argued throughout that its claim was warranted and the parties' entered into a settlement agreement that preserved Travelers' rights. Nor was Travelers' financial position "unimpaired" by PG&E's bankruptcy filing, as PG&E claims *Id.* In fact, Travelers' financial position did not become unimpaired until *after* it negotiated its treatment under PG&E's plan of reorganization and settled the litigation that PG&E brought against it. And, contrary to PG&E's assertion, Travelers *did* prevail on numerous legal points, and the parties settled the remaining disputed issues. Thus, Travelers pressed successfully for the protection of its future rights, as well as those of the injured employees covered by its bond. Ultimately, Travelers incurred the bulk of its attorneys' fees responding to PG&E's pointless suit against Travelers, in which PG&E sought unsuccessfully to eliminate Travelers' rights associated with its $100 million bond. Travelers is entitled to its claim for attorneys' fees, and PG&E cannot justify the *Fobian* rule indirectly by criticizing Travelers.

The decision below conflicts with prior precedent of this Court. Accordingly, certiorari is warranted.

C. Respondent Mischaracterizes The Issue Before The Court.

PG&E opposes certiorari on the ground that the petition "includes a thorny, fact-bound contractual issue" concerning whether Travelers' claim for its fees falls within the scope of its indemnity agreements. Opp. Br. 24. This contention is meritless. It is abundantly clear that the courts below ruled on Travelers' claim for attorneys' fees *as a matter of law* and never reached any other question, including whether Travelers' fees fall within the scope of its contract. Pet. App. 9a, 25a. PG&E's contrary assertion constitutes a transparent attempt to obfuscate the pure question of law decided by the courts below and presented in Travelers' petition.

Nor could the Court face any "thorny fact-bound issue" of contract interpretation if certiorari is granted because none of the courts below decided this issue. *See Cooper Indus., Inc.*, 543 U.S. at 168-69 ("'We ordinarily do not decide in the first

instance issues not decided below.'") (quoting *Adarand Constr., Inc.*, 534 U.S. at 109). In addition, the issue is not part of the question presented. *See Glover v. United States*, 531 U.S. 198, 205 (2001) ("[W]e do not decide issues outside the questions presented by the petition for certiorari."). Finally, PG&E would not be entitled to "smuggle in" the issue. *See Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Corp.*, 510 U.S. 27, 34 (1994) ("[W]e continue to strongly 'disapprove the practice of smuggling additional questions into a case after we grant certiorari.'") (quoting *Irvine v. California*, 347 U.S. 128, 129 (1954)) (plurality opinion).

CONCLUSION

For the foregoing reasons, the Court should grant the petition for writ of certiorari. Alternatively, Petitioner requests summary reversal.

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(2)

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NO. 05-1429

IN THE

Supreme Court of the United States

TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA,

Petitioner

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICUS CURIAE* THE SURETY & FIDELITY ASSOCIATION OF AMERICA IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI OF TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA

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STATEMENT OF INTEREST OF AMICUS CURIAE

The Surety & Fidelity Association of America ("SFAA")[1] is a trade association of companies licensed to write fidelity and surety bonds in the United States. The approximately 500 members of SFAA write the vast majority of surety bonds furnished in California and other states.

Surety bonds are provided in return for both a premium and an agreement by the bond principal to indemnify the surety against liability, loss and expense, including attorneys' fees, incurred by reason of the execution of the bonds. In the instant case, the contracts between petitioner Travelers Casualty and Surety Company of America, as administrator for Reliance Insurance Company ("Travelers")[2] and respondent Pacific Gas and Electric Company ("PG&E") obligated PG&E to indemnify Travelers for its attorneys' fees incurred in the PG&E bankruptcy. The Ninth Circuit Court of Appeals refused to

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[1] No person or entity other than The Surety & Fidelity Association of America made any monetary contribution to the preparation or submission of this Brief, and counsel for the parties did not author this Brief in whole or in part.

[2] The indemnity agreements named, and the bonds were furnished by, Travelers' predecessor in interest, Reliance Insurance Company.

enforce the attorneys' fee provisions of the indemnity contracts because the dispute between Travelers and PG&E was decided under federal bankruptcy law instead of state law.

The rule asserted by the Ninth Circuit increases a surety's risk by arbitrarily depriving it of a part of the consideration promised to induce it to furnish the bond. Indemnity agreements similar to the ones provided by PG&E are routinely required in connection with all types of surety bonds. SFAA's members are adversely impacted by the Ninth Circuit's decision.

Both Petitioner and Respondent have consented to the filing of this Brief.

SUMMARY OF ARGUMENT

The Ninth Circuit Court of Appeals rejected Travelers' argument that state law should control its claim to recover attorneys' fees incurred in protecting its rights in PG&E's bankruptcy proceeding. Even if federal law applies, however, the Ninth Circuit failed to follow this Court's precedents. The American Rule on attorneys' fees applicable in cases arising under federal law is that fees may be recovered if provided for in an enforceable

contract. Thus, the Ninth Circuit's holding was contrary to both state and federal law.

This case presents an important, recurring question that impacts a wide range of contracts in addition to indemnity agreements required in connection with all types of surety bonds. The Ninth Circuit's refusal to enforce contractual attorneys' fee provisions if federal bankruptcy law is used to decide a dispute adversely impacts parties to the many different types of contracts with attorneys' fee shifting provisions. Travelers' Petition presents an important issue that this Court should exercise its discretion to review in order to resolve a clear conflict among the circuit courts of appeal.

ARGUMENT

The Ninth Circuit Court of Appeals decision in this case[3] was that "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'"[4] The Ninth Circuit's decision did not

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[3] *Travelers Casualty and Surety Company v. Pacific Gas and Electric Company*, 2006 WL 285977 (9th Cir. February 7, 2006). Petition Appendix page 1a.

[4] Pet. App. p.3a, quoting from *Fobian v. Western Farm Credit Bank*, 951 F.2d 1149, 1153 (9th Cir. 1991).

depend on the attorneys' fee provision of the parties' contract or on which party prevailed. The Court followed a bright line rule that parties cannot contract to shift attorneys' fees incurred litigating issues controlled by bankruptcy law.

The rule applied by the Ninth Circuit in this case and in *DeRoche v. Arizona Industrial Commission*[5] is clearly in direct conflict with decisions of other circuit courts of appeal.[6] SFAA will not repeat Travelers' explanation of the circuit conflicts. SFAA files this Brief to make two points. First, that the Ninth Circuit holding also conflicts with this Court's application of the American Rule in matters controlled by federal law,[7] and, second, that the issue presented by Travelers' Petition is an important matter which this Court should exercise its

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[5] 434 F.3d 1188 (9th Cir.2006), a Petition for Writ of Certiorari is pending in the *DeRoche* case, Case No. 05-1439.

[6] See pp. 13-15 of Travelers' Petition for a Writ of Certiorari.

[7] Supreme Court Rule 10(c), "a United States court of appeals . . . has decided an important federal question in a way that conflicts with relevant decisions of this Court."

discretion to decide in order to resolve the conflicting decisions of the circuit courts.[8]

I. The American Rule Under Federal Law Enforces Contractual Attorneys' Fee Provisions.

The Bankruptcy Code neither requires nor prohibits attorneys' fee shifting. Travelers argues that bankruptcy law recognizes a right to attorneys' fees under state law.[9] The Ninth Circuit, however, makes a distinction between issues controlled by state law and issues controlled by federal bankruptcy law. In *DeRoche*, the Ninth Circuit stated:

> However, we consistently have refused to award fees when the substantive legal question was governed by federal bankruptcy law. . . .

(434 F.3d at 1191).

In matters controlled by federal law, the American Rule is to enforce contractual attorneys' fee provisions.

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[8] Supreme Court Rule 10(a), "a United States Court of appeals has entered a decision in conflict with the decision of another United States court of appeals on the same important matter."

[9] Petition for a Writ of Certiorari at pp. 15-20.

Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714, 87 S. Ct. 1404, 18 L. Ed.2d. 475 (1967), arose under the Lanham Act. The Court stated the American Rule as:

> The rule here has long been that attorney's fees are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefor.

(386 U.S. 717, 87 S. Ct. 1407).

F.D. Rich Co., Inc. v. U.S. ex rel. Industrial Lumber Co., Inc., 417 U.S. 116, 94 S. Ct. 2157, 40 L. Ed. 2d 703 (1974), held that an action on the payment bond required by the Miller Act[10] was governed by federal law and the Ninth Circuit erred in resorting to "state policy" to award fees. This Court stated:

> The Miller Act provides a federal cause of action, and the scope of the remedy as well as the substance of the rights created thereby is a matter of federal not state law. Neither respondent nor the court below offers any

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[10] 40 U.S.C. §§ 3131, et seq.

> evidence of congressional intent to incorporate state law to govern such an important element of Miller Act litigation as liability for attorneys fees.

(417 U.S. 127, 94 S. Ct. 2164).

The Court in *F.D. Rich* also recognized that a contract's attorneys' fee provision would be enforced. The Court, citing *Fleischmann Distilling Corp.*, stated:

> We turn now to the question of whether attorneys' fees were properly awarded respondent as a successful Miller Act plaintiff. The so-called 'American Rule' governing the award of attorneys' fees in litigation in the federal courts is that attorneys' fees 'are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefor.' . . . There was no contractual provision concerning attorneys' fees in this case.

(417 U.S. 126, 94 S. Ct. 2163).

See also, *Summit Valley Industries, Inc. v. Local 112, United Brotherhood of Carpenters and Joiners of*

America, 456 U.S. 717, 721, 102 S. Ct. 2112, 2114, 72 L. Ed.2d 511 (1982)("Under the American Rule it is well established that attorney's fees 'are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefore.'"); *Hall v. Cole*, 412 U.S. 1, 4, 93 S.Ct. 1943, 1945, 36 L. Ed.2d 702 (1973)("Although the traditional American Rule ordinarily disfavors the allowance of attorneys' fees in the absence of statutory or contractual authorization. . ."); *Alyeska Pipeline Service Company v. Wilderness Society*, 421 U.S. 240, 257, 95 S. Ct. 1612, 1621, 44 L. Ed.2d 141 (1975)("Other recent cases have also reaffirmed the general rule that, absent statute or enforceable contract, litigants pay their own attorneys' fees.")

Following *F.D. Rich*, courts, including the Ninth Circuit,[11] have awarded attorneys' fees to successful Miller Act payment bond claimants if their contracts provided for fees. This is not because state law entitled them to fees. It

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[11] *United States ex rel. Reed v. Callahan*, 884 F.2d 1180, 1185-1186 (9th Cir. 1989), *Cert. Den. Esto, Inc. v. Callahan*, 493 U.S. 1094 (1990); *United States ex rel. Palmer Construction, Inc. v. Cal. State Elec., Inc.*, 940 F.2d 1260 (1991); *North Star Terminal & Stevedore Co. v. Nugget Construction, Inc.*, 126 Fed. Apx. 348, 2005 WL 487313 (9th Cir. 2005).

is because the American Rule under federal law enforces fee shifting by contract.

Thus, in the instant case, the Ninth Circuit reached a result contrary to both state and federal law. Nothing in the Bankruptcy Code forbids parties from allocating the cost of attorneys' fees by contract. California law and federal law recognize such contracts as an exception to the American Rule. If Congress wanted to forbid enforcement of contractual fee shifting in cases decided under the Bankruptcy Code, it could have done so. In the absence of such a statute, however, the Ninth Circuit is not free to legislate its own Ninth Circuit law contrary to both state law and this Court's decisions on federal law.

II. The Issue Presented by Travelers' Petition Should be Decided by This Court.

PG&E could have met its obligations to injured employees by purchasing workers compensation insurance. Instead of paying to have an insurer assume the obligations, however, PG&E chose to self-insure and pay the workers itself. Under California law, it had to provide security for

its obligations to the injured workers.[12] A surety bond was one of the permitted forms of security.[13]

Unlike an insurer, the surety on the bond did not take over primary responsibility for the benefits. PG&E remained primarily liable, and the surety merely guaranteed PG&E's performance. The risk the surety ran was that workers would be owed benefits and that PG&E would be unable to pay them.

To induce Travelers to become surety on the bonds, and thus assume a potential $100 million liability, and to keep the cost of the bonds as low as possible, PG&E executed the indemnity agreements. In Paragraph Second of the first two Agreements, PG&E promised:

> SECOND: To indemnify, and keep indemnified, and hold and save harmless the Surety against all demands, claims, loss, costs, damages, expenses and attorneys' fees whatever, and any and all liability therefor, sustained or incurred by the Surety by reason of executing or procuring the

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[12] Cal. Labor Code §3701.

[13] Cal. Labor Code §3701(d).

> execution of any said Bond or Bonds, or any other Bonds, which may be already or hereafter executed for or at the request of the Undersigned, or renewal or continuation thereof; or sustained or incurred by reason of making any investigation on account thereof, prosecuting or defending any action brought in connection therewith, obtaining a release therefrom, recovering or attempting to recover any salvage in connection therewith or enforcing by litigation or otherwise any of the agreements herein contained. Payment of amounts due Surety hereunder together with legal interest shall be payable upon demand.

(Excerpts of Record in the Ninth Circuit at pp. 41 and 45).

The third agreement stated at its second paragraph, "PG&E Corporation agrees to indemnify the Surety and hold [it] harmless in respect of any and all loss, damages, claims, costs, premiums, expenses and reasonable attorney's fees which the Surety may incur by reason of its having furnished the aforesaid Workers Compensation Bond." (Excerpts of Record at p. 51).

PG&E did not just agree to indemnify Travelers for losses paid under the bonds.[14] It also promised to indemnify Travelers for expenses, including attorneys' fees, incurred "by reason of executing" the bonds. Paragraph Second then goes on to obligate PG&E to pay any attorneys' fees incurred in connection with enforcement of the indemnity agreement. Thus, PG&E's promise to pay Travelers' attorneys' fees was not limited to actions on the indemnity contract itself. Any fees incurred by reason of the execution of the bonds were covered.

Surety bonds are required in connection with a multitude of activities including all public construction projects over a minimal size.[15] Indemnity agreements substantially similar to the ones PG&E provided Travelers are routinely obtained in connection with all kinds of surety bonds.[16] These agreements help reduce the cost of bonds

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[14] Indeed, such a promise would be largely superfluous because Cal. Civ. Code §2847 would obligate PG&E as principal on the bonds to pay Travelers for any losses.

[15] For federal construction, the Miller Act, 40 U.S.C. §§ 3131, et seq., requires performance and payment bonds. In California, Civ. Code §3247 requires payment bonds on public construction contracts.

[16] See, Klinger, et al., *The Surety's Indemnity Agreement* (American Bar Association 2002) and Shahinian, "The

and assure that any losses and expenses are paid by the bond principal or other persons or entities who agree to act as indemnitors for the principal's obligations to the surety. If bond principals do not have to live up to their promises because a dispute is decided under federal bankruptcy law instead of state law, the loss experience and costs of bonds will increase.

The same is true for other types of transactions in which attorneys' fee shifting provisions are used. If one party is obligated to pay the other party's attorneys' fees, the indemnified party can charge less for its products or services. It recovers the cost of enforcing the contract from the defaulting party. If such an indemnification provision is unenforceable, the attorneys' fees have to be factored into the cost of the products or services. Then, all parties purchasing the products or services pay an increased price. The uncollectible attorneys' fees are spread over all customers rather than being paid by the defaulting party.

In the instant case, PG&E is well able to pay Travelers' attorneys' fees, but the Ninth Circuit rule bars enforcement of the attorneys' fee provisions in the

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General Indemnity Agreement" in Gallagher, ed. *The Law of Suretyship, 2nd Ed.* (American Bar Association 2000) at pp. 487-525.

indemnity agreements. In this one instance, the consequences to Travelers' other customers may be minimal, but applied to the myriad of contracts with attorneys' fee shifting provisions, the cumulative effect of the Ninth Circuit rule is substantial and deserving of this Court's attention.

CONCLUSION

This Court should exercise its discretion to grant Travelers' Petition for a Writ of Certiorari to resolve the conflicting holdings of the circuit courts of appeal and the conflict between the holding of the Ninth Circuit Court of Appeals and this Court's controlling decisions.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED MAY 8, 2006
CERTIORARI GRANTED OCTOBER 6, 2006

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Appendix M — Excerpted Transcript Of Proceedings — Objection To Amended Claim Of Travelers Casualty & Surety Company, et al. Dated July 11, 2003 ..... 125a

The following opinion, orders, transcript and statutes have been omitted in printing this Joint Appendix because they appear in the appendix of the Petition for a Writ of Certiorari on the following pages:

Memorandum Opinion Of The United States Court Of Appeals For The Ninth Circuit Filed February 7, 2006 ..... 1a

Order Of The United States District Court For The Northern District Of California Dated February 18, 2004 ..... 4a

Order Of The United States Bankruptcy Court For The Northern District Of California, San Francisco Division Dated July 11, 2003 ..... 20a

Transcript Of Proceedings Of The United States Bankruptcy Court For The Northern District Of California, San Francisco Division Dated July 11, 2003 ..... 22a

Relevant Statutes 26a

APPENDIX A — RELEVANT DOCKET ENTRIES

U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
(SAN FRANCISCO)
BANKRUPTCY PETITION #: 01-30923

04/06/2001	41	Order Granting Motion For Authority to Pay Pre-Petition Compensation and Benefits by Pacific Gas and Electric Co. (Entered: 04/09/2001)
09/20/2001	2236	Disclosure Statement of Plan of Reorganization Under Chapter 11 of the Bankruptcy Code By Debtor Pacific Gas and Electric Co. and PG&E Corp. (Entered: 09/20/2001)
11/27/2001	3530	Objection By Creditor Travelers Casualty and Surety Co. To [2236-1] Disclosure Statement to Accompany Debtor's Plan of Reorganization dated September 20, 2001 by Pacific Gas and Electric Co. (Entered: 11/30/2001)
12/03/2001	3712	Objection By Creditor Travelers Casualty and Surety Co. To [2236-1] Disclosure Statement of Pacific Gas and Electric Co. (Entered: 12/07/2001)
01/28/2002	4534	Transcript of Hearing Held on January 14, 2001 (Entered: 01/30/2002)

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02/06/2002	4707	Plan Proponents' Summary of and Response By Debtor Pacific Gas and Electric Co. To . . . [references to other objections omitted for purposes of Joint Appendix] Objection by Travelers Casualty and Surety Co., [3712-1] Objection by Travelers Casualty and Surety Co., [3497-1] . . . [additional references omitted] . . . [4707-1] Response by Pacific Gas and Electric Co. (Entered: 02/07/2002)
03/07/2002	5028	Second Amended Plan of Reorganization Under Chapter 11 of the Bankruptcy Code Filed by Debtor Pacific Gas and Electric Co. (Entered: 03/08/2002)
03/18/2002	5274	Notice of Debtor's Objection and Objection To Claim Numbers: #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Company of America (Entered: 03/19/2002)
04/19/2002	6053	Chapter 11 Plan Of Reorganization Filed By Debtor Pacific Gas and Electric Corp., Debtor Pacific Gas and Electric Co. (Dated April 19, 2002) (Entered: 04/22/2002)
05/06/2002	6315	Response By Creditor Travelers Casualty and Surety Co. To [5274-1]

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		Claims Objection To Claim Numbers: #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Company of America by Pacific Gas and Electric Co. (Entered: 05/06/2002)
05/06/2002	6316	Declaration Of Susan M. Camilli filed by Creditor Travelers Casualty and Surety Co. in Support RE: [6315-1] Response To [5274-1] Claims Objection To Claim Numbers: #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Company of America by Pacific Gas and Electric Co. by Travelers Casualty and Surety Co. (Entered: 05/06/2002)
05/06/2002	6317	Motion by Creditor Travelers Casualty and Surety Co. For Leave to File Enlarged Response to the Debtor's Objection to its Claims that Exceeds Page Limitation (Entered: 05/06/2002)
05/[illegible]002	6318	Declaration Of G. Eric Brustad, Jr. filed by Creditor Travelers Casualty and Surety Co. in Support of [6317-1] Motion For Leave to File Enlarged Response to the Debtor's Objection to its Claims that Exceeds Page Limitation by Travelers Casualty and Surety Co. (Entered: 05/06/2002)

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07/17/2002	8907	Objection By Creditor Travelers Casualty and Surety Co. RE: [6566-1] Chapter 11 Plan by CA Public Utilities Commission, [6053-1] Chapter 11 Plan by Pacific Gas and Electric Co., Pacific Gas and Electric Corp. (Entered: 07/19/2002)
11/08/2002	10974	Stipulation By Creditor Travelers Casualty and Surety Co. and Order Resolving Objections to Claims of Travelers Casualty and Surety Company (Claims #8869, #9911, #9912, and #11335) (Entered: 11/12/2002)
11/13/2002	11029	Notice of Entry of Order RE: [10974-1] Stipulation Order Objections to Claims of Travelers Casualty and Surety Company (Claims #8869, #9911, #9912, and #11335) by Travelers Casualty and Surety Co., [10974-2] Stipulation Order by Travelers Casualty and Surety Co. (Entered: 11/14/2002)
03/07/2003	12324	Notice of Objection and Objection To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co., Filed By Debtor Pacific Gas and Electric Co. (Entered: 03/10/2003)

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05/15/2003	12811	Response Filed by Creditor Travelers Casualty and Surety Co. To RE: related document(s) 12324 Notice of Objection and Objection To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 05/20/2003)
05/20/2003	12828	Notice of Errata Filed by Creditor Travelers Casualty and Surety Co. Regarding (RE: related document(s) 12811 Response Filed by Creditor Travelers Casualty and Surety Co. To RE: related document(s) 12324 Notice of Objection and Objection By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 05/21/2003)
05/20/2003	12829	Declaration of G. Eric Brunstad, Jr. Filed by Creditor Travelers Casualty and Surety Co. in Support of RE: related document(s) 12811 Response Filed by Creditor Travelers Casualty and Surety Co. To (RE: related document(s) 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 05/21/2003)

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06/27/2003	13034	Disclosure Statement for Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company Proposed By Pacific Gas and Electric Company, PG&E Corporation, and the Official Committee of Unsecured Creditors Filed by Debtor Pacific Gas and Electric Co., and Creditor PG&E Corp. (Entered: 07/01/2003)
07/07/2003	13081	Reply Filed by Debtor Pacific Gas and Electric Co. RE: 12811 Response Filed by Creditor Travelers Casualty and Surety Co. To RE: related document(s) 12324 Notice of Objection and Objection To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 07/09/2003)
07/11/2003	13131	Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 07/15/2003)
07/11/2003	13133	Hearing Held RE: 12324 Notice of Objection and Objection To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 07/15/2003)

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07/14/2003	13138	Notice of Entry of Order Filed by Debtor Pacific Gas and Electric Co. RE:13131 Order Sustaining: 12324 Notice of Objection and Objection To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 07/16/2003)
07/18/2003	13170	Objection Filed by Creditor Travelers Casualty and Surety Co. RE:13034 Disclosure Statement for Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company Proposed By Pacific Gas and Electric Company, PG&E Corporation, and the Official Committee of Unsecured Creditors (Entered: 07/18/2003)
07/21/2003	13175	Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. [Receipt Number 30026448, Fee Amount $ 105.00] RE: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co.; Appellant Designation due by 7/31/2003; Transmission to District Court due by 8/20/2003 (Entered: 07/21/2003)

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07/21/2003	13176	Notice of Objection Filed by Creditor Travelers Casualty and Surety Co. To Referral of Appeal to the Bankruptcy Appellate Panel (Entered: 07/21/2003)
07/21/2003	13176	Statement of Election to District Court Filed by Creditor Travelers Casualty and Surety Co. RE: 13175 Notice of Appeal, Filed by Creditor Travelers Casualty and Surety Co.; Appellant Designation due by 7/31/2003 (Entered: 07/21/2003)
07/21/2003	13177	Certification of Interested Entities or Persons Filed by Creditor Travelers Casualty and Surety Co. (Entered: 07/21/2003)
07/30/2003	13291	Appellant Designation of Contents For Inclusion in Record On Appeal Filed by Creditor Travelers Casualty and Surety Co. RE: 13175 Notice of Appeal RE: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co, 13176 Statement of Election on Appeal filed by Creditor Travelers Casualty and Surety Co. Appellee Designation Due by 8/11/2003 (Entered: 08/04/2003)

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07/30/2003	13292	Statement of Issues on Appeal, Filed by Creditor Travelers Casualty and Surety Co. RE: 13175 Notice of Appeal RE: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 08/04/2003)
07/30/2003	13293	Appellant Designation of Contents For Inclusion in Record On Appeal (Pursuant to Fed. R. Bankr. P. 8006) Filed by Creditor Travelers Casualty and Surety Co. RE: 13175 Notice of Appeal RE: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co.; Appellee Designation Due by 8/11/ 2003 (Entered: 08/04/2003)
07/30/2003	13294	Request for Transcript Filed by Creditor Travelers Casualty and Surety Co. RE: 13175 Notice of Appeal RE: 13131 Order Sustaining 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912

		and 11335 of Travelers Casualty and Surety Co.; Transcript Due by 8/29/2003 (Entered: 08/04/2003)
07/31/2003	13298	Plan of Reorganization Filed by Debtor Pacific Gas and Electric Co., Creditor Pacific Gas and Electric Corp. Creditor Official Committee of Unsecured Creditors Under Chapter 11 of the Bankruptcy Code for Pacific Gas & Electric Company Dated July 31, 2003 (Entered: 08/04/2003)
07/31/2003	13299	Disclosure Statement For Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas & Electric Company Proposed by PG&E, PG&E Corp. and the Official Committee of Unsecured Creditors Dated July 31, 2003 (Entered: 08/04/2003)
07/31/2003	13314	Notice of Docketing Record on Appeal (District Court Number: C03-3499-PJH) RE: 13175 Notice of Appeal Filed by Creditor Travelers Casualty and Surety Co. RE: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 08/05/2003)

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08/07/2003	13354	Transcript Re: Appeal RE: 13294 Request for Transcript Filed by Creditor Travelers Casualty and Surety Co. and 13175 Notice of Appeal RE: 13131 Order Sustaining 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 08/07/2003)
08/08/2003	13355	Appellant Designation of Supplemental Document (Transcript for the Proceedings held July 11, 2003) For Inclusion in Record On Appeal RE: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. [Receipt Number 30026448, Fee Amount $ 105.00] RE: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 08/08/2003)
08/08/2003	13356	Transmittal of Record on Appeal to U.S. District Court RE: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. [Receipt Number

		30026448, Fee Amount $ 105.00] RE: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 08/08/2003)
08/08/2003	13357	Certificate of Record Re: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. [Receipt Number 30026448, Fee Amount $ 105.00] RE: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 08/08/2003)
08/08/2003	13357	Courts Certificate of Mailing (Number of Notices Mailed: 12) RE: 13357 Certificate of Record Re: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. [Receipt Number 30026448, Fee Amount $ 105.00] RE: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims

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#8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 08/08/2003)

08/08/2003	13372	Appellee Designation Filed by Debtor Pacific Gas and Electric Co. of Additional Items to Include in the Record on Appeal RE: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. and Counter-Statement of Issues on Appeal. (Entered: 08/12/2003)
08/12/2003	13390	Errata To Appellee Designation Filed by Debtor Pacific Gas and Electric Co. Of Additional Items to Include in the Record on Appeal 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. (Entered: 08/12/2003)
08/12/2003	13390	Counter-Statement of Issues on Appeal Filed by Debtor Pacific Gas and Electric Co. RE: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. (Entered: 08/12/2003)
08/15/2003	13416	Second Supplement to Record on Appeal Filed by Appellant Travelers Casualty and Surety Co. RE: 13175

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Notice of Appeal Filed by Creditor Travelers Casualty and Surety Co. (Entered: 08/15/2003)

08/15/2003	13417	Transmittal of Second Supplemental Document to be Included on Appeal to U.S. District Court RE: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. (Entered: 08/15/2003)
09/02/2003	13542	Objection Filed by Creditor Travelers Casualty and Surety Co. RE: 13298 Plan of Reorganization Filed by Debtor Pacific Gas and Electric Co., Creditor PacificGas and Electric Corp. Creditor Official Committee of Unsecured Creditors UnderChapter 11 of the Bankruptcy Code for Pacific Gas & Electric Company Dated July 31, 2003 (Entered: 09/04/2003)
09/12/2003	13657	Notice of Briefing From the US District Court RE: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. (Entered: 09/18/2003)
11/10/2003	14043	Stipulation and Order Resolving Objection of Travelers Cas. and Surety Company to Plan of Reorganization

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		Under Chapter 11 of the Bankruptcy Code for PG&E Co., PG&E Corp., and the OCC Dated July 31, 2003 (Entered: 11/13/2003)
11/13/2003	14072	Notice of Entry of Order Filed by Debtor Pacific Gas and Electric Co. RE:14043 Stipulation and Order Resolving Objection of Travelers Casualty and Surety Company to Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for PG&E Co., PG&E Corp., and the OCC Dated July 31, 2003 (Entered: 11/17/2003)
12/12/2003	14237	Order Overruling: 13542 Objection Filed by Creditor Travelers Casualty and Surety Co. RE: 13298 Plan of Reorganization Filed by Debtor Pacific Gas and Electric Co., Creditor PacificGas and Electric Corp. Creditor Official Committee of Unsecured Creditors Under Chapter 11 of the Bankruptcy Code for Pacific Gas & Electric Company Dated July 31, 2003 (Entered: 12/15/2003)
12/22/2003	14272	Order Confirming: 13298 Plan of Reorganization Filed by Debtor Pacific Gas and Electric Co., Creditor Pacific Gas and Electric Corp. Creditor Official Committee of Unsecured

Appendix A

Creditors Under Chapter 11 of the Bankruptcy Code for Pacific Gas & Electric Company Dated July 31, 2003, As Modified (Entered: 12/22/2003)

04/09/2004	15079	District Court Order By Judge Hamilton Affirming Bankruptcy Court's Ruling Regarding: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. To: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 04/09/2004)
04/09/2004	15080	District Court Judgment By Judge Hamilton Affirming Bankruptcy's Court Decision Regarding: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. To: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 04/09/2004)

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04/09/2004	15081	Appeal Now Pending at 9th Circuit of Appeals (USCA# 04-15605) RE: 13175 Notice of Appeal (USDC# C03-3499-PJH) Filed by Creditor Travelers Casualty and Surety Co. To: 13131 Order Sustaining: 12324 Notice of Objection and Objection Filed By Debtor Pacific Gas and Electric Co. To Amended Claims #8869, 9911, 9912 and 11335 of Travelers Casualty and Surety Co. (Entered: 04/09/2004)

Appendix A

U.S. DISTRICT COURT
CALIFORNIA NORTHERN DISTRICT
(SAN FRANCISCO)
CIVIL DOCKET FOR CASE #: 3:03-CV-03499

07/29/2003	1	Notice of APPEAL FROM BANKRUPTCY COURT. Bankruptcy Court case number 01-30923 DM. File received. Filed by Creditor Travelers Casualty and Surety Company. (Entered: 07/30/2003)
09/12/2003	11	BANKRUPTCY RECORD ON APPEAL; CERTIFICATE OF RECORD (Entered: 09/12/2003)
11/04/2003	23	Appellant's BRIEF by Creditor Travelers Casualty and Surety Company. Appellee Brief due by 11/4/2003. (Entered: 11/04/2003)
11/04/2003	24	Declaration of Tymchenko in Support of 23 *Appellant's BRIEF* filed by Creditor Travelers Casualty and Surety Company. (Attachments: # 1 Exhibit A# 2 Exhibit B# 3 Exhibit C# 4 Exhibit D# 5 Exhibit E# 6 Exhibit F# 7 Exhibit G# 8 Exhibit H# 9 Exhibit I# 10 Exhibit J# 11 Exhibit K# 12 Exhibit L# 13 Exhibit M# 14 Exhibit N# 15 Exhibit O# 16 Exhibit P) (Related document(s) 23) (Entered: 11/04/2003)

Appendix A

12/15/2003	25	Appellee's Brief On Appeal filed by Pacific Gas and Electric Co. (Entered: 12/15/2003)
12/15/2003	26	Appellee's Excerpts of Record filed by Pacific Gas and Electric Co.. (Attachments: # 1 Exhibit One# 2 Exhibit Two# 3 Exhibit Three# 4 Exhibit Four# 5 Exhibit Five# 6 Exhibit Six) (Entered: 12/15/2003)
12/24/2003	28	Reply Memorandum *Reply Brief* filed by Creditor Travelers Casualty and Surety Company. (Entered: 12/24/2003)
12/24/2003	29	MOTION for Hearing re 28 Reply Memorandum,, 25 Memorandum in Opposition *Request for Oral Argument* filed by Creditor Travelers Casualty and Surety Company. (Entered: 12/24/2003)
01/09/2004	30	RESPONSE to *Appellant's Request for Oral Argument* by Pacific Gas and Electric Co.. (Attachments: # 1 Exhibit Order Re Appellant's Request For Oral Argument) (Entered: 01/09/2004)
02/18/2004	32	ORDER affirming bankruptcy court. Signed by Judge Hamilton on Feb 18, 2004. (Entered: 02/18/2004)

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02/18/2004	33	JUDGMENT in favor of Appellee. Signed by Judge Hamilton on 02/18/04. (Entered: 02/18/2004)
03/17/2004	34	NOTICE OF APPEAL as to 32 Order, 33 Judgment by Creditor Travelers Casualty and Surety Company. Filing fee $ 255, receipt number 3357921. (Filed on 3/17/2004) (Entered: 03/25/2004)
03/17/2004		Received Document USCA Civil Appeals Docketing Statement by Creditor Travelers Casualty and Surety Company. (Filed on 3/17/2004) (Entered: 03/25/2004)
03/18/2004	35	AMENDED NOTICE OF APPEAL as to 32 Order, 33 Judgment by Creditor Travelers Casualty and Surety Company. (Filed on 3/18/2004) (Entered: 03/25/2004)
03/18/2004		Received Document USCA Amended Civil Appeals Docketing Statement by Creditor Travelers Casualty and Surety Company. (Filed on 3/18/2004) (Entered: 03/25/2004)
03/25/2004	36	DESIGNATION of Record on Appeal by Creditor Travelers Casualty and Surety Company re [35] Notice of Appeal, [34] Notice of Appeal (Entered: 03/25/2004)

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03/25/2004	37	TRANSCRIPT DESIGNATION *Pursuant to Circuit Rule 10-3.1* by Creditor Travelers Casualty and Surety Company for proceedings held [ ] (Entered: 03/25/2004)
03/25/2004	38	NOTICE by Creditor Travelers Casualty and Surety Company re 37 Transcript Designation *Statement of Issues on Appeal* (Entered: 03/25/2004)
04/07/2004	39	NOTICE by Pacific Gas and Electric Co. *Counter-Statement Of Issues On Appeal* (Entered: 04/07/2004)
08/19/2005		Certified and Transmitted Record on Appeal to US Court of Appeals (Entered: 08/19/2005)
03/06/2006	41	MANDATE of USCA: AFFIRMED. (Filed on 3/6/2006) (Entered: 03/09/2006)
03/06/2006	42	USCA JUDGMENT. The judgment of the said District Court in this cause is AFFIRMED. (Filed on 3/6/2006) (Entered: 03/09/2006)

Appendix A

Court of Appeals Docket #: 04-15605

9/3/04	Received Appellant Travelers Casualty's brief in 50 copies 44 pages (Informal: n) deficient : no Excerpts: notified counsel. Served on 9/3/ 04 [04-15605]
9/3/04	Filed original and 15 copies Appellant Travelers Casualty opening brief (Informal: n) 44 pages and five excerpts of record in 2volumes; served on 9/3/04 [04-15605]
9/13/04	Filed motion of Appellant and deputy clerk order : referring to panel motion to take judicial notice, any response thereto, and any furture such requests. [5175314-1] (Motion recvd 9/3/04) [04-15605]
10/27/04	Filed original and 15 copies appellee PG&E's 53 pages brief, 5 suppl Exc. in 1 vol: ; served on 10/27/04 [04-15605]
10/27/04	Filed PG&E motion to take judicial notice [04-15605] served on 10/27/04 [5219063] RECORDS FOR MERITS PANEL PER 9/13/ 04 ORDER reply brief due 11/29/04
11/29/04	Filed original and 15 copies Travelers Casualty reply brief, (Informal: n) 25 pages; served on 11/29/04 [04-15605]

Appendix A

10/17/05	ARGUED AND SUBMITTED TO Stephen R. REINHARDT, Sidney R. THOMAS, Jane A. Restani [04-15605]
11/21/05	Received G. Eric Brunstad for Appellant Travelers Casualty letter dated 11/18/05 re: Siegel v. Home Loan Mortgage. [04-15605]
2/7/06	FILED MEMORANDUM DISPOSITION: AFFIRMED (Terminated on the Merits after Oral Hearing; Affirmed; Written, Unsigned, Unpublished. Stephen R. REINHARDT, Sidney R. THOMAS, Jane A. Restani) FILED AND ENTERED JUDGMENT. [04-15605]
3/1/0	MANDATE ISSUED [04-15605]
5/15/06	Received notice from Supreme Court: petition for certiorari filed Supreme Court No. 05-1429 filed on 5/8/06. [04-15605]
10/10/06	Received notice from Supreme Court, petition for certiorari GRANTED on 10/6/06 . Supreme Court No. 05-1429

APPENDIX B — ORDER ON DEBTOR'S EMERGENCY MOTION FOR AUTHORITY TO PAY PRE-PETITION COMPENSATION AND BENEFITS DATED AND FILED APRIL 6, 2001

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

Case No. 01-30923 DM

Chapter 11

HEARING

Date: April 6, 2001
Time: 3:00 p.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California

In re

PACIFIC GAS AND ELECTRIC COMPANY,
a California corporation,

Debtor.

Federal I.D. No. 94-0742640

ORDER ON DEBTOR'S EMERGENCY MOTION FOR AUTHORITY TO PAY PRE-PETITION COMPENSATION AND BENEFITS

The Court, having considered the Emergency Motion for Authority to pay Pre-Petition Compensation and Benefits (the

"Motion") submitted by Pacific Gas and Electric Company, the debtor and debtor in possession in the above-captioned Chapter 11 case (the "Debtor" or "PG&E"), the Declaration of Russell M. Jackson in support thereof, any opposition to the Motion, the record in this case, and any admissible evidence presented to the Court at or prior to the hearing on the Motion, hereby finds as follows:

A. Adequate notice of this proceeding was given to parties in interest as appropriate under the circumstances.

B. There is good cause for granting the Motion.

Based on the foregoing, **IT IS HEREBY ORDERED** THAT:

1. The Motion is *GRANTED* as provided herein.

2. The Debtor is authorized to pay the pre-petition portion of: (1) regularly incurred wages (including accrued vacation and sick leave); (2) payroll taxes and other payroll deductions; (3) employee health benefits; (4) employer contributions to the employee retirement savings plans; (5) reimbursable employee business expenses; (6) disability and worker's compensation obligations; and (7) payments pursuant to all other regular employee welfare benefits policies, except for any payment with respect to the Supplemental Retirement Savings Plan.

DATED: April 6, 2001

s/ Dennis Montali
HONORABLE DENNIS MONTALI
UNITED STATES BANKRUPTCY JUDGE

Appendix B

Proof Of Claim
Dated September 4, 2001

[*See* Supplemental Joint Appendix]

APPENDIX C — EXCERPTS OF PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE FOR PACIFIC GAS AND ELECTRIC COMPANY DATED AND FILED SEPTEMBER 20, 2001

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

Case No. 01 30923 DM

Chapter 11

[No Hearing Requested]

In re:

PACIFIC GAS AND ELECTRIC COMPANY,
a California corporation,

Debtor.

Federal I.D. No. 94-0742640

PLAN OF REORGANIZATION
UNDER CHAPTER 11 OF THE BANKRUPTCY CODE
FOR PACIFIC GAS AND ELECTRIC COMPANY
[Dated September 20, 2001]

[Commencing at page 48]

* * *

(h) *Assumed Indemnification Obligations.* Entry of the Confirmation Order shall, subject to and upon the occurrence

of the Effective Date, constitute the approval, pursuant to Sections 365(a) and 1123(b)(2) of the Bankruptcy Code, of the assumption of the Assumed Indemnification Claims. The Assumed Indemnification Claims shall, in all respects, irrespective of whether such claims arise under contracts or executory contracts, survive confirmation of the Plan, remain unaffected thereby, and not be discharged irrespective of whether indemnification, defense, reimbursement of limitation is owed in connection with an event occurring before, on or after the Petition Date.

(i) *Compensation and Benefit Programs.* Except as provided in Section 6.1 of the Plan, all savings, retirement, health care, severance, performance-based cash incentive, retention, employee welfare benefit, life insurance, disability and other similar plans and agreements, all directors and officers liability and other insurance and all workers' compensation programs are treated as executory contracts under the Plan and shall, on the Effective Date, be deemed assumed by the Debtor in accordance with Section 365(a) and 1123(b)(2) of the Bankruptcy Code.

(j) *Retiree Benefits.* Payments, if any, due to any Person for the purpose of providing or reimbursing payments for retired employees and their spouses and dependents for medical, surgical, or hospital care benefits, or benefits in the event of sickness, accident, disability, or death under any plan, fund, or program (through the purchase of insurance or otherwise) maintained or established in whole or in part by the Debtor prior to the Petition Date shall be continued for the duration of the period the Debtor has obligated itself to provide such benefits.

* * * *

APPENDIX D — AMENDED OBJECTION OF TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA ET AL. TO DEBTOR'S DISCLOSURE STATEMENT TO ACCOMPANY DEBTOR'S PLAN OF REORGANIZATION DATED SEPTEMBER 20, 2001, FILED DECEMBER 3, 2001

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

Case No. 01-30923 DM

Chapter 11 Case

Date: December 19, 2001
Time: 9:30 a.m.
Place: 235 Pine Street
San Francisco, CA

In re

PACIFIC GAS AND ELECTRIC COMPANY,
a California Corporation,

Debtor.

Federal I.D. No. 94-0742640

AMENDED OBJECTION OF TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA ET AL. TO DEBTOR'S DISCLOSURE STATEMENT TO ACCOMPANY DEBTOR'S PLAN OF REORGANIZATION DATED SEPTEMBER 20, 2001

Appendix D

Travelers Casualty and Surety Company et al. (collectively, "Travelers"),[1] by and through its undersigned counsel, hereby submits its objections (the "Objection") to the Disclosure Statement For Plan of Reorganization Under Chapter 11 of the Bankruptcy Code For Pacific Gas and Electric Company Proposed By Pacific Gas and Electric Company and PG&E Corporation (the "Disclosure Statement") dated September 20, 2001 and, in support thereof, respectfully represents and alleges as follows:

Procedural History and Background

On April 6, 2001, Pacific Gas and Electric Company (the "Debtor") filed a voluntary petition for relief under Chapter 11 of title 11 of the United States Bankruptcy Code, § 101 *et seq.* On September 20, 2001, the Debtor filed its Disclosure Statement together with its Plan of Reorganization (the "Plan").

From time to time prior to the commencement of the Debtor's chapter 11 case, Travelers issued on behalf of the Debtor various surety bonds (collectively, the "Bonds") assuring the Debtor's performance of various obligations to third parties including, without limitation, workers' compensation obligations. On September 5, 2001, Travelers filed a proof of claim in the above-captioned case (the

1. The parties represented by this Objection are as follows: Travelers Casualty and Surety Company of America and Travelers Casualty and Surety Company as Administrator for Reliance Insurance Company for itself, as successor in interest by merger with United Pacific Insurance Company, and for Related Reliance Insurance Companies.

"Claim") with respect to the Debtor's obligations under the Bonds. The Claim, as well as the Bonds which are the subject of the Claim, are attached hereto as Exhibit A. In addition, the Debtor's obligations to Travelers under the Bonds are the subject of a indemnification agreement executed by the Debtor's parent, PG&E Corporation (the "Parent").

Objection of Travelers

Travelers objects to the Disclosure Statement principally because it fails to provide adequate information regarding the disposition of the Bonds, and, correspondingly, the treatment of the Debtor's obligations to Travelers under the Bonds. Indeed, the only clear reference to any surety bond is the single sentence appearing on pages 95 and 96 stating that "[t]he parent also guarantees the $401 million of surety bonds the Debtor has in place to secure its workers' compensation obligations." (Disclosure Statement, at 95-96). Although the Disclosure Statement is quite specific in detailing the disposition and treatment of other claims (including the Debtor's reimbursement obligations to issuers of certain letters of credit, *see id.* at 107), it provides no meaningful discussion of the treatment of the Debtor's obligations to Travelers. Accordingly, with respect to Travelers, the Disclosure Statement fails to provide "adequate information" within the meaning of section 1125 of the Bankruptcy Code and should not be approved.

Pursuant to section 1125, adequate information "means information of a kind . . . that would enable a hypothetical reasonable investor . . . to make an informed judgment about the plan. . . ." 11 U.S.C. § 1125(a)(1). As noted by one court:

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> The burden of deciphering the meaning of the treatment of a claim should not be placed upon a creditor . . . it is important for these average investors/general unsecured creditors that the Disclosure Statement contain . . . language delineating the consequences of the proposed plan on their claims and the possible [Bankruptcy] Code alternatives so that they can intelligently accept or reject the Plan.

In re Ferretti, 128 B.R. 16, 19 (D.N.H. 1991); *see also* 11 U.S.C. § 1123 (specifying the contents of a plan).

In this instance, the Disclosure Statement fails to provide adequate information regarding Travelers' Claim because it fails to provide even the most rudimentary information regarding the disposition of the Debtor's obligations under the Bonds. Moreover, to the extent that the Disclosure Statement provides general information regarding the Debtor's disposition of its obligations that may or may not bear on the treatment of Travelers' Claim, this information is similarly oblique and inadequate.

For example, the Disclosure Statement indicates that the Debtor is to be divided into separate entities under the terms of certain agreements, including a "master separation and distribution agreement." (Disclosure Statement, at 92). The Disclosure Statement further provides that "[t]he agreements will generally provide for the transfer of assets and assumption of liabilities relating to the business lines, . . . employee matters, indemnification and insurance arrangements" and other matters. (*Id.*). It may be that the

Debtor intends for Travelers' Claim to be affected by these agreements. At the present time, however, this intention remains entirely unclear, and the relevant details have not been supplied.

The Disclosure Statement also provides that "[e]xisting liabilities relating to personal injury, property damage, products liability, . . employment or similar claims against the Debtor, other than the Chromium Litigation, will follow the assets and, as future liabilities arise, they will be the liabilities of the owner of the assets." (*Id.* at 93). It may be that this statement likewise has some bearing on Travelers' Claim. Again, however, this also remains unclear.

The Disclosure Statement further states that, upon the occurrence of certain events, "the current Parent guarantees of the Debtor's workers' compensation obligations will be assumed by the Debtor." (*Id.*, at 96). To the extent that this statement is intended to have any bearing on Travelers' claim, particularly with respect to the Parent's guarantee, this intent should be clarified.

In its present form, the Disclosure Statement fails to provide adequate information regarding the treatment of Travelers' Claim and the disposition of the Bonds. Accordingly, Travelers respectfully requests that this Court: (i) deny approval of the Disclosure Statement; and (ii) grant Travelers such other and further relief as the Court deems appropriate.

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Dated: November 30, 2001.

Respectfully Submitted,

Travelers Casualty and Surety Company
By and through its Counsel:

s/ G. Eric Brunstad, Jr.
G. Eric Brunstad, Jr.
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APPENDIX E — EXCERPTED TRANSCRIPT OF PROCEEDINGS BEFORE THE HONORABLE DENNIS MONTALI UNITED STATES BANKRUPTCY JUDGE DATED JANUARY 14, 2002

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

Case No. 01-30923-DM

San Francisco, California
Monday, January 14, 2002
9:32 A.M.

Chapter 11

Disclosure statement hearing

In re:

PACIFIC GAS AND ELECTRIC COMPANY,

Debtor.

TRANSCRIPT OF PROCEEDINGS BEFORE THE HONORABLE DENNIS MONTALI UNITED STATES BANKRUPTCY JUDGE

[Commencing at page 93]

* * *

MR. BRUNSTAD: Thank you, Your Honor. Eric Brunstad on behalf of Traveler's, Your Honor.

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What this — what our claim basically involves is primarily worker's compensation benefits. Traveler's issued, before the bankruptcy filing, a $100 million worker's compensation bond, and this is one I think that the debtor — it's important to get right, not only for disclosure statement purposes, but also for operational purposes if the debtors hope to reorganize.

The — obviously, the debtor has employees. Some of those employees get injured. They're entitled to worker's compensation benefits. The debtor is self-insured, meaning it's paid the benefits. But under state regulations, being self-insured, they have to have surety bonds from sources like Traveler's and other surety companies. Traveler's is one of several sureties.

And in this situation, Traveler's filed a proof of claim for the $100 million bond, and also filed 501(b) claims on behalf of all of the claimants. Traveler's has additional [94] bonds that it's issued in various amounts, I think there are about 270 of them, mostly to various state enterprises.

But for purposes of today, Your Honor, I wanted to focus on the worker's comp bonds. And this is basically how it works, and then I'll address why the disclosure statement is inadequate.

Essentially, Your Honor, Traveler's as a surety has two sets of rights. One is its reimbursement right under its general indemnity obligation with the company, it also has the guarantee of the parent for the full amount of the bond, $100 million bond.

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In addition, Traveler's has rights under Section 509, it's subrogation rights to stand in the shoes of the workers. It's imperative from our perspective that the plan detail what's happening to the worker's compensation claims, and unfortunately, looking at the disclosure statement and plan, we're left to guess, we don't know.

We don't know, for example — what happens typically in cases like this is that the claims of the workers are rendered unimpaired. The debtor will simply continue to make all the pre-petition worker's compensation payments in the ordinary course, uninterrupted through confirmation and thereon.

That's relevant to the surety, obviously, because under 509, it has the same rights as the workers in the event [95] the payments are not paid.

What's also relevant is to understand what's happening with respect to the parent guarantee. Now, what the plan tells us, or what the disclosure statement tells us is that there are general unsecured creditors. What we don't know is, are the worker's compensation claims going to be lumped in the general unsecured class?

That doesn't make any sense, because you don't simply give worker's comp — those entitled to worker's compensation benefits notes, or cash payments. In fact, in some jurisdictions, that's prohibited, because they don't want the employees taking a lump sum of all their future benefits, and going off and spending them somehow.

MR. LOPES: Your Honor, if I might cut this short, I haven't had a — we haven't had a chance to have a conversation, but we've got a first day order that authorizes continuing worker's comp in the ordinary course, and —

MR. BRUNSTAD: Yeah. Yes, that's not — it's not what's happening during the case, Your Honor, it's what's going to happen under the plan, and what Traveler's obviously wants to know is what's going to happen to these claims once the plan is confirmed.

Now, we want to know, for example, are they going to — obviously there's going to be some mechanism where I suppose the liabilities on the worker's comp obligations are [96] going to be split apart among the various different entities. That's important to know.

We assume, but we don't know, because we're not being told, that the worker's comp liabilities, perhaps being rendered unimpaired, will be allocated among the different debtors that are to emerge. We don't know what's going to happen with respect to Traveler's subrogation rights, because that's not specified in the plan in any place, and we don't know —

THE COURT: Well, let me stop you for a minute. Is this a disclosure item?

MR. BRUNSTAD: Yes, Your Honor.

THE COURT: Who's the voting creditor?

MR. BRUNSTAD: Well, that's a good question, Your Honor. Traveler's filed proofs of claim on behalf of all of the worker's compensation claimants under 501(b).

THE COURT: But are there pre-petition arrearages?

MR. BRUNSTAD: There are — we don't know, Your Honor.

THE COURT: Okay.

MR. BRUNSTAD: But there are pre-petition claims. Let me make this explicit, Your Honor.

THE COURT: All right.

MR. BRUNSTAD: The worker who was injured before the bankruptcy is filed has a pre-petition worker's compensation [97] claim —

THE COURT: Yes.

MR. BRUNSTAD: — which is paid over time. So notwithstanding the fact that payments mature from here — in the past and in the future, the claim is pre-petition. So you have a whole group of creditors out there who are these injured employees who will ostensibly be continued to receive benefits until they are no longer eligible to receive benefits under applicable state law.

THE COURT: You mean their rights presumably would pass through?

MR. BRUNSTAD: If they are rendered unimpaired.

THE COURT: I mean, any individual who was injured pre-petition may have a claim in the traditional sense, but he or she has been paid up to the petition date, and so you're really just talking about entitlements that continue post-petition?

MR. BRUNSTAD: Well, Your Honor, I think that the best characterization of it, and this is how I've seen it done in other plans, like LTV's plan, and et cetera, are that these are all pre-petition claims that mature in various amounts in the future.

Sometimes under applicable state law you can present value them and give a lump sum, but that's not the preferred way for obvious policy reasons.

[98] In this situation, I understand that these pre-petition claims, the injuries all occurred pre-petition, the liability is established pre-petition, the payments that are made on a monthly, or periodic basis are paid, and will continue to be paid into the future. But they're on account of all pre-petition claims.

So again, it's very simple. Traditionally, what happens is that the debtor wants to render these unimpaired, because if the debtor doesn't render these unimpaired under the plan, they may not be able to get self-insured surety coverage, the state may not allow them to get that post-confirmation, and as I note under the debtor's disclosure statement, they intend to go for self-insurance, but like I said at the outset, this is

an issue which has to be gotten right, in order for their potential program to work.

It also has to be gotten right under 1125, because we need to know what's happening to the claims.

THE COURT: Well, Mr. Lafferty, the summary that you've put together says by way of a response that Traveler's is treated as an unsecured creditor. But your comment is silent on the underlying claimants. What —

MR. LAFFERTY: I'm not sure we understood the rest of the objection. We heard the objection and we responded.

THE COURT: Well, I have the amended objection here, I have it in front of me. I took counsel's word that he was [99] summarizing what he wrote. But let's take a simple answer. What is the fate of pre-petition worker's comp claimants under the post-confirmation regime?

MR. CANTU: Your Honor, Oscar Cantu speaking.

THE COURT: Yes.

MR. CANTU: To make it simple, I believe what we're prepared to do, regardless of what the current state of affairs is, is just to add a statement that makes clear that the claims of the workers themselves will pass through with the reorganized debtor remaining obligated to pay for them.

There may be some allocation done between the entities and some of the agreements — excuse me.

(Counsel confer)

MR. CANTU: Excuse me, I've been corrected now, they'll pass through to the reorganized debtor and the LLCs based on, you know, where the worker was, was basically employed, you know, who they were performing services for in terms of the different divisions.

THE COURT: So if an employee worked in the transmission part of the company, his claim would be honored by E-Trans, or G-Trans —

MR. CANTU: By light transit, yes, sir. Yes.

THE COURT: And the reorganized debtor as well? Both? Jointly?

MR. CANTU: Well, no, only the reorganized debtor if [100] it's a disco claim.

MR. LOPES: If he worked for them.

MR. CANTU: Yes.

THE COURT: Okay.

MR. BRUNSTAD: Okay. The magic words I'm hoping to hear, perhaps I am hearing them, is that they're rendered unimpaired.

THE COURT: Unimpaired.

MR. CANTU: Yes.

THE COURT: Well, Mr. Cantu —

MR. CANTU: Yes?

THE COURT: — what I'm hearing is you're going to flag them and identify these individuals as a separate class, a new class that's not presently in the plan.

MR. LAFFERTY: No, Your Honor.

THE COURT: No?

MR. BRUNSTAD: Well, they have to be classified somehow.

THE COURT: Well, yes, I mean, that's — I saw a head shake.

MR. CANTU: Yes, it's probably easier just to do that at this stage.

THE COURT: But I mean, isn't that a simple solution to say class such and such, or pre-petition worker's comp claims?

[101] MR. CANTU: But the logistics of changing all the class numbers, yes.

THE COURT: Well, put them at the end.

MR. BRUNSTAD: Put them at the end, I don't care if it's in 12(b).

THE COURT: I don't think Mr. Brunstad cares what the class designation is.

MR. BRUNSTAD: I don't, Your Honor.

THE COURT: Right?

MR. BRUNSTAD: Yeah. They obviously can't be classified with general unsecured creditors, they're not going to be treated the same way.

THE COURT: Well, now, then, Traveler's, I guess, itself, however, is really just a contingent claim, isn't it?

MR. BRUNSTAD: But it has subrogation rights, Your Honor.

THE COURT: Yes.

MR. BRUNSTAD: What we'd also like to know is whether our subrogation rights are being rendered unimpaired under 509(a). Simply put, that solves the problem.

THE COURT: Can we have a position on that?

MR. CANTU: Your Honor, I don't believe a subrogation right is a claim against the debtor. It's the right to step into someone else's claim and whatever that treatment is, it is.

[102] THE COURT: Yeah, that's what I thought too. You don't have a separate claim, you just take over the claim.

MR. BRUNSTAD: A long as nothing in the plan will, or purports to impair Traveler's subrogation rights, I'll settle for that.

THE COURT: Well, can we solve that problem, then, by you're defining this new class to be the claimants, but then provide and/or Traveler's to the extent that by subrogation it takes over the claim, words to that effect?

MR. CANTU: Certainly.

MR. LAFFERTY: Certainly.

MR. BRUNSTAD: Terrific, Your Honor.

The second feature of this was Traveler's guarantee with respect to the parent, and this is the language that troubled me in the disclosure statement, and I just didn't understand it, it wasn't clear to me, and this is also one of the issues of our objection.

The language in the disclosure statement, as I read it, purports to provide that the various new entities are going to assume all of the parent's responsibility with respect to worker's compensation obligations, and that that will terminate the parent's guarantee of all the worker's compensation obligations of the debtor.

That, to me, sounds like what they're trying to do, but I'm not sure, is to terminate Traveler's guarantee against [103] the parent, not simply releasing their obligation to the parent, but actually terminating Traveler's guarantee which the parent has issued to Traveler's.

THE COURT: Traveler's is a beneficiary of a guarantee obligation of PG&E Corp.

MR. BRUNSTAD: The parent corp.

THE COURT: And you're concerned that somehow this plan purports to tear that guarantee up?

MR. BRUNSTAD: That's what it seems to suggest on page 136 of the disclosure statement, and what I would like is a clarification that nothing will effect Traveler's guarantee with respect to the parent. It says, "The proponents are evaluating the option of purchasing worker's compensation insurance as a means of eliminating the parent's guarantee of past worker's compensation obligations of the debtor."

THE COURT: Well, by the way, is the extent guarantee one of those that is terminable for future exposure?

MR. BRUNSTAD: It's terminable for — I have it right here, Your Honor.

THE COURT: Well, I don't. But I mean, you can — I mean typically, if the guarantee can be terminated, it doesn't get you off the hook for prior liability, but it terminates you for future liability. So what —

MR. BRUNSTAD: I think for future, it works that way. But what we're concerned about, obviously, is terminating for [104] prior.

THE COURT: Well, the law wouldn't permit that, would it?

MR. KESSLER: Your Honor, the short answer is that the plan is not attempting to release third party claims against third parties.

If Traveler's has a claim against the parent, that's a third party claim against a third party.

THE COURT: Right.

MR. KESSLER: And we are — we will terminate the guarantee on a going forward basis, but not as to claims that existed as of the date of termination.

MR. BRUNSTAD: That's great. That's what I was hoping to get.

MR. KESSLER: We're not suggesting that we have any additional rights to terminate third party claims against third parties.

THE COURT: Mr. Brunstad, are you satisfied with that statement on the record, or are you asking that the disclosure statement say something?

MR. BRUNSTAD: I would like that to be in the disclosure statement, Your Honor.

THE COURT: All right. Looking at 136, the paragraph begins, "At such time as self-insurance is implemented,

proponents expect to terminate the existing agreement of [105] assumption and guarantee of liabilities. . ." et cetera. What would you suggest inserting right around there?

MR. BRUNSTAD: We can talk about language, Your Honor, but it would be something to the effect that nothing in the plan or disclosure statement purports to terminate Traveler's rights under any guarantee with the parent with respect to obligations which Traveler's has bonded, to the date of whatever, when we're talking about.

THE COURT: Mr. Cantu, in concept —

MR. LAFFERTY: Going toward the language, the language says, such termination will eliminate the parent's obligation for any future worker's compensation obligations of the reorganized debtor.

THE COURT: Be quiet, you're the debtor's counsel. You're not the parent's counsel.

MR. LAFFERTY: Sorry.

THE COURT: Mr. Cantu, any objection to the concept of just putting a little comfort sentence in there that —

MR. CANTU: I have a lot of objection to his language, I mean, it's — as stated, Your Honor, but —

MR. BRUNSTAD: Well, I think we understand the concept, we can smith the language so that it states, I think, what we all have been talking about anyway.

MR. CANTU: I think just as an opening point, Your Honor, I'm not sure I understand what problem he has with the [106] existing language that's in there, because I think it says exactly what is being articulated as the issue.

THE COURT: This is one of those classic, if the language is good enough, why isn't he happy, but if you put an innocuous thing in there that says nothing's effected, why aren't — what's your problem? And so the rule on disclosure statement is put it in rather than take it out.

So any reason conceptually putting in a statement to that effect?

MR. CANTU: None at all.

THE COURT: Okay.

MR. CANTU: Other than it's what's there now, but again, I don't mind adding something if it makes him more comfortable.

THE COURT: Okay.

MR. CANTU: I do need to make one comment —

THE COURT: Yes, sir.

MR. CANTU: — about his prior addition that he was seeking, Your Honor.

THE COURT: Okay.

MR. CANTU: I'm not sure we can say in connection with the worker's comp claimants simply that Traveler's has subrogation claims and so they may be, you know, that some of the claims may be theirs. We'll have to do it more generically. I'm just saying this in terms of full disclosure.

[107] MR. BRUNSTAD: That's fine.

MR. CANTU: Because there are other insurers, it's not only Traveler's.

MR. BRUNSTAD: That's fine, Your Honor.

THE COURT: The point is, it's anyone who steps up and pays the claim is subrogated, and takes over the 509 position.

MR. CANTU: Absolutely.

MR. BRUNSTAD: That's terrific, Your Honor.

THE COURT: Okay.

MR. BRUNSTAD: Now, with respect to the last category, which all the other bonds that Traveler's has filed, I assume that again, just consistent with that, Traveler's subrogation rights will remain intact to the extent that those underlying claimants have claims and they're not paid by the debtor, and Traveler's just simply has its subrogation rights, and I think we can leave it at that.

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THE COURT: Okay. Well, then, you can get back to Connecticut and take care of your ear —

MR. BRUNSTAD: Sure.

THE COURT: — but before you go, just work out some mutually satisfactory language with Mr. Cantu, and the next round of the plan will presumably reflect that.

MR. BRUNSTAD: Thank you very much, Your Honor.

THE COURT: All right. Thank you very much.

* * * *

APPENDIX F — SECOND AMENDED PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE FOR PACIFIC GAS AND ELECTRIC COMPANY DATED MARCH 7, 2002

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

Case No. 01 30923 DM

Chapter 11 Case

[No Hearing Requested]

In re

PACIFIC GAS AND ELECTRIC COMPANY,
a California corporation,

Debtor.

Federal ID. No. 94-0742640

~~[PROPOSED MODIFICATIONS AS OF FEBRUARY 4, 2002, MARKED TO SHOW CHANGES TO THE DRAFT SUBMITTED TO THE BANKRUPTCY COURT ON JANUARY 10, 2002]~~

~~FIRST~~SECOND AMENDED PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE FOR PACIFIC GAS AND ELECTRIC COMPANY

[Dated ~~December 19, 2001~~March 7, 2002]

[MARKED TO SHOW CHANGES TO THE DRAFT SUBMITTED TO THE BANKRUPTCY COURT ON ~~JANUARY 10, 2002]~~ FEBRUARY 4, 2002]

Appendix F

Counsel for the Debtor, Pacific Gas and Electric Company:

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* * *

Appendix F

4.20 *Class 11—QUIDS Claims.*

(a) *Allowance.* The QUIDS Claims shall be deemed Allowed QUIDS Claims in the amount of $310,000,000.

(b) *Distributions.* Each Allowed QUIDS Claim will be satisfied as follows: (i) all pre-petition interest will be paid in Cash and (ii) the remainder of such Allowed Claim will be paid one hundred percent (100%) in QUIDS Notes.

(c) *Impairment and Voting.* Class 11 is impaired by the Plan. Each holder of an Allowed QUIDS Claim is entitled to vote to accept or reject the Plan.

4.21 *Class 12 - Workers' Compensation Claims.*

(a) *Distributions.* Each Allowed Workers' Compensation Claim arising prior to the Petition Date shall be satisfied in full in the ordinary course of business at such time and in such manner as the Reorganized Debtor, ETrans, GTrans or Gen, as the case may be, is obligated to satisfy such Allowed Claim under applicable law. Post-petition Workers' Compensation Claims are treated as Administrative Expense Claims herein and shall receive the same pass-through treatment as Workers' Compensation Claims arising prior to the Petition Date. Nothing herein shall affect (i) the subrogation rights, to extent applicable or available, of any surety of pre-petition or post-petition Workers' Compensation Claims *or (ii) the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of any such subrogation rights.*

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(b) *Impairment and Voting.* Class 12 is unimpaired under the Plan. Each holder of an Allowed Workers' Compensation Claim is conclusively presumed to have accepted the Plan and is not entitled to vote to accept or reject the Plan.

4.22 *Class 13 - Preferred Stock Equity Interests.*

(a) *Treatment.* Each holder of a Preferred Stock Equity Interest shall retain its Preferred Stock in the Reorganized Debtor and shall be paid in Cash any dividends and sinking fund payments accrued in respect of such Preferred Stock through the last scheduled payment date prior to the Effective Date.

* * *

~~with the Clerk of the Bankruptcy Court on or prior to the date on which the Disclosure Statement and the Ballot are transmitted to the creditors for voting.~~

~~(a) schedules listing the members of the Boards of Control and officers of ETrans, GTrans and Gen;~~

~~(b) schedules listing the directors and officers of Newco and the Reorganized Debtor;~~

~~(c) a schedule of the surplus property and property rights to be sold pursuant to Section 7.5(a) hereof;~~

~~(d) the Land Management Agreement between the Lan Holdings and Gen.~~

Appendix F

~~The information filed with the Ancillary Plan Materials will be limited to the documents listed above. Upon its filing with the Bankruptcy Court, the Ancillary Plan Materials may be inspected in the office of the Clerk of the Bankruptcy Court during normal court hours or through the "Pacific Gas & Electric Company Chapter 11 Case" link available through the website maintained by the Bankruptcy Court at http://www.canb.uscourts.gov. Holders of Claims or Equity interests also may obtain a copy of the Ancillary Plan Materials upon written request to the Debtor at the address set forth in Section 11.15 hereof. In addition, the compensation to be paid to the members of the boards of control and officers of ETrans, GTrans, and Gen and the directors and officers of the Reorganized Debtor and Newco will be provided to the Bankruptcy Court and will be available on the Bankruptcy Court's website prior to the commencement of the Confirmation Hearing.~~

11.20 *Exhibits/Schedules.* All exhibits and schedules to the Plan, including the Plan Supplement ~~and the Ancillary Plan Materials~~, are incorporated into and are a part of the Plan as if set forth in full herein.

11.21 *Subrogation Rights.* ~~The~~Nothing in the Plan shall affect (a) the subrogation rights of any surety, to the extent applicable or available, ~~shall be unaffected by the Plan and~~which, if available or applicable, shall remain in full force and effect; or (b) the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of such subrogation rights.

DATED: ~~December 19, 2001~~March 7, 2002

Appendix F

PACIFIC GAS AND ELECTRIC COMPANY

By: _____
Gordon R. Smith
President and Chief Executive Officer

PG&E CORPORATION

By: _____
Robert D. Glynn, Jr.
Chairman of the Board, Chief Executive Officer and President

APPROVED AS TO CONTENT AND FORM:

HOWARD, RICE, NEMEROVSKI, CANADY, FALK & RABKIN, A Professional Corporation

By: _____
Attorneys for Debtor and Debtor-in-Possession

WEIL, GOTSHAL & MANGES LLP

By: _____
Attorneys for PG&E Corporation

DEWEY BALLANTINE LLP

By: _____
Attorneys for PG&E Corporation

APPENDIX G — SECOND AMENDED DISCLOSURE STATEMENT FOR SECOND AMENDED PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE FOR PACIFIC GAS AND ELECTRIC COMPANY PROPOSED BY PACIFIC GAS AND ELECTRIC COMPANY AND PG&E CORPORATION DATED MARCH 7, 2002

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

Case No. 01 30923 DM

Chapter 11 Case

[No Hearing Requested]

In re

PACIFIC GAS AND ELECTRIC COMPANY,
a California corporation,

Debtor.

Federal ID. No. 94-0742640

~~[PROPOSED MODIFICATIONS AS OF FEBRUARY 4, 2002, MARKED TO SHOW CHANGES TO THE DRAFT SUBMITTED TO THE BANKRUPTCY COURT ON JANUARY 10, 2002, FOR THE DISCLOSURE STATEMENT HEARING ON FEBRUARY 7, 2002 AT 1:30 P.M.]~~

Appendix G

~~FIRST~~SECOND AMENDED DISCLOSURE STATEMENT FOR ~~FIRST~~SECOND AMENDED PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE FOR PACIFIC GAS AND ELECTRIC COMPANY PROPOSED BY PACIFIC GAS AND ELECTRIC COMPANY AND PG&E CORPORATION

[Dated ~~December 19, 2001~~March 7, 2002]

[MARKED TO SHOW CHANGES TO THE DRAFT SUBMITTED TO THE BANKRUPTCY COURT ON FEBRUARY 4, 2002]

Counsel for the Debtor, Pacific Gas and Electric Company:

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Appendix G

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Professor Laurence Tribe
Hauser Hall 420
1575 Massachusetts Avenue
Cambridge, Massachusetts 02138

* * *

As a result of the Restructuring Transactions contemplated by the Plan, the Debtor will also enter into negotiations to address the effects on the bargaining unit from the transfer of assets.

4. *Workers' Compensation Obligations.*

Every private employer in California is required to provide workers' compensation coverage, either by purchasing workers' compensation insurance or, with the

permission of the State, self insuring. To self-insure, employers must meet certain criteria for financial strength and stability and must provide security to cover their future workers' compensation liabilities in the event they default on obligations to pay benefits. The security must be in the form of cash, approved securities, surety bonds or irrevocable letters of credit. The Debtor is self-insured and the Parent has entered into an Agreement of Assumption and Guarantee of Liabilities on behalf of the Debtor. The Parent also guarantees the $401 million of surety bonds the Debtor has in place to secure its workers' compensation obligations.

After the Effective Date, the Reorganized Debtor, ETrans, GTrans and Gen plan to satisfy their workers' compensation obligations through self-insurance. The Reorganized Debtor plans to remain self-insured, while ETrans, GTrans and Gen will each apply for approval to self-insure. In each case, approval to self-insure is discretionary. Once approval is obtained, each of ETrans, GTrans and Gen will have its own self-insurance certificate.

When self-insurance is implemented, the Reorganized Debtor and ETrans, GTrans and Gen will be required to post separate collateral to the State to support their self-insured programs. The Proponents currently anticipate that the collateral requirements will be approximately $342 million in 2003. Of that amount, it is anticipated that the Reorganized Debtor will post $205 million and ETrans, GTrans-and Gen collectively will post $137 million.

Appendix G

Nothing in this Disclosure Statement or the Plan shall affect (i) the rights of any surety or the Parent with respect to the Workers' Compensation Indemnity Agreements or (ii) the rights of the parties to object to the existence of such rights. Notwithstanding the foregoing, at such time as self-insurance is implemented, the Proponents expect to terminate the existing Agreement of Assumption and Guarantee of Liabilities which provides for the Parent's guarantee of the workers' compensation obligations of the Debtor to the State. Such termination will eliminate the Parent's obligation for any future workers compensation obligations of the Reorganized Debtor. The Proponents are evaluating the option of purchasing workers' compensation insurance as a means of eliminating the Parent's guarantee of past workers' compensation obligations of the Debtor. Such purchase would require collateral. Nevertheless, while self-insurance has been identified as the likely and preferable approach to workers' compensation, the Reorganized Debtor, ETrans, GTrans and Gen will also evaluate the possibility of purchasing workers' compensation insurance, which would also require collateral.

5. *Treatment of Stock Options.*

Each individual who holds unexercised options to purchase common stock of the Parent (the "Parent Options") under the PG&E Corporation Long-Term Incentive Program will have such options converted into options to acquire common stock of the Parent (the "Parent Replacement Options") and options to acquire common stock of the Reorganized Debtor (the "Reorganized Debtor Options").

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The number of Parent Replacement Options and Reorganized Debtor Options issued to each affected individual shall be equal to the number of unexercised Parent Options held immediately prior to the Reorganized Debtor Spin-Off. The resulting options will maintain the original Parent Option vesting and expiration provisions.

For each grant of Parent Options, the per share exercise price of the corresponding Parent Replacement Options and Reorganized Debtor Options shall be calculated in a manner designed to satisfy the principles of accounting standard FIN 44 by multiplying the exercise price of the original Parent Option by ratios reflecting the relative values of Parent common stock or Reorganized Debtor common stock on the date of the Reorganized Debtor Spin-Off.

K. *REGULATORY IMPACT OF THE PLAN.*

~~Upon consideration of the Plan, except insofar as CPUC regulation of GTrans and Gen will be superseded by FERC regulation,[20] the existing regulation of the Debtor's operations by~~

* * *

~~20. The FERC already regulates the rates, terms and conditions of electric transmission service. ETrans will continue the business of transmitting electric energy in interstate commerce, and will thus continue under FERC jurisdiction. The FERC will regulate GTrans and Gen because their activities after the Effective Date will be interstate rather than intrastate. Gen will be engaged solely in making sales for resale; such wholesale sales rae, by definition, in interstate commerce. See FPA~~

* * *

Appendix G

Certain holders of certain debt senior to the QUIDS have stated that the treatment of the QUIDS Claims under the Plan violates a contractual subordination agreement between the holders of such senior debt and the holders of QUIDS Claims. The Debtor does not believe that the treatment of the QUIDS Claims under the Plan violates such contractual subordination provision. Nonetheless, absent acceptance of the Plan by the senior debt classes, the Debtor cannot guarantee that holders of such senior debt will not attempt to enforce such alleged subordination rights.

22. *Class 12—Workers' Compensation Claims.*

Class 12 includes any Workers' Compensation Claims arising prior to the Petition Date. Class 12 is unimpaired under the Plan. Each Allowed Workers' Compensation Claim arising prior to the Petition Date shall be satisfied in the ordinary course of business at such time and in such manner as the Reorganized Debtor, ETrans, GTrans or Gen, as the case may be, is obligated to satisfy such Allowed Claim under applicable law. Post-petition Workers' Compensation Claims are treated as Administrative Expense Claims under the Plan and shall receive the same pass-through treatment as Workers' Compensation Claims arising prior to the Petition Date. Nothing in this Disclosure Statement or the Plan shall affect (i) the subrogation rights, to the extent applicable or available, of any surety of pre-petition or post-petition Workers' Compensation Claims or (ii) the rights of Debtor to object, pursuant to the Bankruptcy Code, to the existence of such subrogation rights.

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23. *Class 13—Preferred Stock Equity Interests.*

Class 13 includes the Debtor's First Preferred Stock, par value $25.00 per share, and the Debtor's $100 First Preferred Stock, par value $100.00 per share. The Debtor's First Preferred Stock includes: (a) 6% Non-Redeemable First Preferred, (b) 5.5% Non-Redeemable First Preferred, (c) 5% Non-Redeemable First Preferred, (d) 5% Redeemable First Preferred Series D, (e) 5% Redeemable First Preferred Series E, (f) 4.80% Redeemable First Preferred, (g) 4.50% Redeemable First Preferred, (h) 4.36% Redeemable First Preferred, (i) 6.57% Redeemable First Preferred, (j) 7.04% Redeemable First Preferred, and (k) 6.30% Redeemable First Preferred.

19. *Minimum Distributions.*

No payment of Cash less than $100 shall be made by the Debtor to any holder of a Claim unless a request therefor is made in writing to the Debtor. Any payment of Cash made by the Debtor pursuant to the Plan shall first be drawn proportionately from the segregated Cash accounts established pursuant to Sections 7.1(e), 7.2(e) and 7.3(e) of the Plan.

20. *Preservation of Certain Claims.*

Schedule 11.18 to the Plan Supplement contains a list of certain contingent and unliquidated claims of the Debtor against third parties. The Debtor retains these claims, as well as any claims that are or were discovered after the date hereof, and reserves its rights to pursue such claims in any appropriate forum, either prior to or following the Effective Date, except as otherwise provided in the Plan.

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21. *Subrogation Rights.*

The subrogation rights of any surety, to the extent applicable or available, shall be unaffected by this Disclosure Statement or any provisions of the Plan and, if applicable or available, shall remain in full force and effect. In addition, the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of any such subrogation rights shall be unaffected by this Disclosure Statement or any provisions of the Plan.

* * * *

APPENDIX H — EXCERPTS OF NOTICE OF DEBTOR'S OBJECTION AND OBJECTION TO CLAIMS OF TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA [CLAIM NOS. 8869, 9911, 9912, AND 11335] DATED AND FILED MARCH 18, 2002

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

No. 01-30923 DM

Chapter 11 Case

Date: April 17, 2002
Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California

In re

PACIFIC GAS AND ELECTRIC COMPANY,
a California corporation,

Debtor.

Federal I.D. No. 94-0742640

NOTICE OF DEBTOR'S OBJECTION AND OBJECTION TO CLAIMS OF TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA [CLAIM NOS. 8869, 9911, 9912, AND 11335]

* * *

Appendix H

OBJECTION TO CLAIMS

I.

BACKGROUND.

1. On April 6, 2001 (the "Commencement Date"), the Debtor commenced a case under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). Since the Commencement Date, the Debtor has continued to operate its business and manage its properties as a debtor in possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code.

2. On or about September 5, 2001, Travelers filed the Claims with the Debtor's claims agent. Travelers' alleged claims against the Debtor arise out of Travelers' surety obligations with respect to certain obligees of the Debtor (the "Obligees"), and, as stated in the Claims, are "unliquidated and contingent as of [September 5, 2001]." The claims are for an unspecified amount of at least $120 million. To date, there is no evidence that Travelers has been called upon to satisfy the Debtor's obligations with respect to the Obligees. Accordingly, the Claims remain contingent and unliquidated. True and correct copies of the Claims are attached hereto as Exhibit "A."

3. The Debtor has reviewed the Claims and objects to such claims for the reasons set forth below.

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II.

OBJECTION.

A. *Claims Numbers 9911, 9912 And 11335 Should Be Disallowed As Duplicative.*

4. Claim Nos. 9911, 9912 and 11335 (collectively, the "Duplicate Claims") are duplicative of Claim No. 8869. With respect to the Duplicate Claims, it appears that Travelers erroneously filed the same proof of claim against the Debtor more than once. Clearly, the Debtor should not be required to pay twice on the same obligation.

5. Therefore, the Debtor objects to each of the Duplicate Claims and requests that such Duplicate Claims be disallowed in their entirety. Because this Objection to the Duplicate Claims does not constitute an objection to the surviving claim, Claim No. 8869, the Debtor reserves the right to object to such surviving claim on any ground whatsoever, including as set forth below. Moreover, any objection by the Debtor to the Claims, shall similarly constitute an objection to the Duplicate Claims to the extent that they are not disallowed as duplicative.

B. *The Claims Should Be Disallowed Pursuant To Bankruptcy Code Section 502(e)(1)(B).*

6. In the Claims, Travelers indicates that it holds contingent, unliquidated claims for reimbursement, subrogation and/or indemnification. Specifically, the Claims provide,

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> "Travelers may hereafter be required to make payments under the Bonds. As a result of such payments, Travelers will become subrogated to the rights of the obligees against the Debtor with respect to such payments and Travelers has the right to be reimbursed and indemnified by the Debtor with respect to all such payments, whether such payments are made on behalf of the Debtor as a principal or on behalf of another principal under any Bond." (Addendum to Travelers Claim Nos. 11335, 8869, 9912, and 9911, ¶5).

7. Regardless of how Travelers chooses to characterize the Claims, such claims must be disallowed pursuant to Section 502(e)(1)(B) of the Bankruptcy Code. Section 502(e)(1)(B) provides as follows:

> "(e)(1) Notwithstanding subsections (a),(b), and (c) of this section and paragraph (2) of this subsection, *the court shall disallow* any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor to the extent that . . . (B) such *claim for reimbursement or contribution is contingent* as of the time of the allowance or disallowance of such claim for reimbursement or contribution." (11 U.S.C. §502(e)(1)(B) (emphases added)

8. A claim must be disallowed under Section 502(e)(1)(B) of the Bankruptcy Code if three elements are established: "(1) the claim is for reimbursement or contribution, (2) the party asserting the claim is liable with

the debtor on the claim of a creditor; and the claim is contingent at the time of allowance or disallowance." *Dant & Russell, Inc. v. Burlington Northern R.R. Co. (In re Dant & Russell, Inc.)*, 951 F.2d 246, 248 (9th Cir. 1991); *In re American Cont'l Corp.*, 119 B.R. 216, 218 (D. Ariz. 1990) (disallowing a contingent claim for reimbursement and/or contribution by an entity, that was co-liable with the debtor); *see also In re Krueger*, 127 B.R. 252, 254 (Bankr. D. Idaho 1991) (denying contingent claim for reimbursement under Section 502(e)(1)(B)).

9. Section 502(e)(1)(B) is broad in scope and is not limited solely to claims for reimbursement and/or contribution. The legislative history of Section 502(e)(1)(B) suggests that "Congress intended to effect a policy of precluding competition between creditors and those whose claims against the estate derive from creditors." *See In re American Cont'l Corp.*, 119 B.R. at 217 (*citing* H.R. Rep. No. 95-595, at 354 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6310; S. Rep. No. 95-989, at 65 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5851).

10. Courts, including this one, have recognized that clai for indemnification fall under the purview of Section 502(e)(1)(B). *See, e.g., Fine Organics Corp. v. Hexcel Corp. (In re Hexcel Corp.)*, 174 B.R. 807, 811 (Bankr. N.D. Cal. 1994) ("[i]n particular, §502(e)(1)(B) was intended to prevent a guarantor from filing a contingent claim for indemnification (before honoring its guaranty) which would compete with the noncontingent claim of the party to whom the debtor was primarily liable"); *In re Pinnacle Brands, Inc.*, 259 B.R. 46, 55 (Bankr. D. Del. 2001) (finding that contractual

indemnification claim amounted to a claim for reimbursement or contribution under Section 502(e)(1)(B) and disallowing such claim); *In re Drexel Burnham Lambert Group, Inc.*, 146 B.R. 92, 96 (S.D.N.Y. 1992) ("it is well-established that contingent claims for indemnity are covered by §502(e)(1)(B)").

11. Travelers' claims for indemnification and/or reimbursement against the Debtor should, accordingly, be disallowed pursuant to section 502(e)(1)(B) because all three elements of Section 502(e)(1)(B) have been satisfied. First, Travelers indicates that its claims against the Debtor are for "reimburse[ment] and indemnifi[cation]." (Addendum to Travelers Claim Nos. 11335, 8869, 9912, and 9911, 15). Second, as a surety to obligations of the Debtor, Travelers is co-liable with the Debtor with respect to such obligations. Finally, Travelers concedes that its claims against the Debtor are contingent and unliquidated. There is no evidence that Travelers has yet been required to honor its surety obligations with respect to the Debtor.

C. *To The Extent That Travelers Asserts A Subrogation Claim, It Should Be Disallowed Under Sections 502(e)(1)(B), 502(e)(1)(C) And 509 Of The Bankruptcy Code.*

12. Similarly, to the extent Travelers asserts subrogation claims, such claims should be disallowed under Sections 502(e)(1)(B) and 509 of the Bankruptcy Code. To the extent Travelers asserts a right of subrogation, such claims are for *prospective* subrogation. Prospective subrogation has been held to fall within the ambit of Section 502(e)(1)(B). *See, e.g., Aetna Cas. & Sur. Co. v. Georgia Tubing Co.*

(In re Chateaugay Corp.), No. 93 Civ. 3659 (LAP), 1995 WL 429018, at *3-*4 (S.D.N.Y. July 20, 1995) ("Aetna's denotation of its claim as one of 'contingent' or 'prospective' subrogation cannot obscure the fact that Aetna is asserting a contingent codebtor claim for reimbursement. . . . [T]he Bankruptcy Court properly disallowed Aetna's claim pursuant to §502(e)(l)(B); it is precisely claims such as Aetna's that §502(e)(1)(B) disallows"), *aff'd*, 93 F.3d 56 (2d Cir. 1996).[3]

13. Furthermore, Travelers' subrogation claims should be disallowed under Section 509(a) of the Bankruptcy Code, which provides, in relevant part, that an entity that is liable with the debtor on, or that has secured, a claim of a creditor against the debtor, *and that pays such claim*, is subrogated to the rights of such creditor to the extent of such payment" (emphasis added). Section 509 clearly provides that claims for subrogation are established only upon a codebtor's payment of the creditor's claim. Thus, *contingent* or

3. In that case, Aetna Casualty & Surety Company ("Aetna") had issued two bonds prepetition to the State of Georgia securing the debtor's obligations under a hazardous waste permit. Although at the time of the filing of its proof of claim (and at the time of the allowance of the claim) Aetna had not yet made any payments under its bonds, Aetna filed a proof of claim in the debtor's bankruptcy case in which it alleged that it " 'may be required to make payments pursuant to some or all of the Bonds in the future' and 'asserts a right of subrogation as to each Bonded Obligation, or portion thereof, which it hereafter pays.' " *Aetna Cas. & Sur. Co. v. Georgia Tubing Corp.*, 93 F.3d 56, 57 (2d Cir. 1996). The district court disallowed Aetna's claim for 'prospective subrogation.' On appeal, the Second Circuit affirmed the district court's holding and noted that Aetna could not obscure its 'contingent codebtor claim for reimbursement' simply by calling such claim one of prospective subrogation.

prospective subrogation under Section 509(a) of the Bankruptcy Code is not possible. *See also In re Chateaugay Corp.*, 1995 WL 429018, at *4 ("Section 509(a) establishes that a codebtor's right of subrogation arises only when and to the extent that the codebtor pays the assured creditor"); *In re Amatex Corp.*, 110 B.R. 168, 168 (Bankr. E.D. Pa 1990) ("the scope of §502(e)(1)(B), in conjunction with 11 U.S.C. §509(a), operates to disallow any contingent co-liability, even if that co-liability has not been judicially established, unless the co-obligor pays the liability and becomes subrogated to the rights of the underlying creditor therefor"). Travelers' claims for subrogation are not valid because, as previously noted, Travelers has not been called upon to honor its surety obligations with respect to the Debtor.

14. In addition, to the extent Travelers asserts subrogation claims, its contingent reimbursement and contribution claims should be disallowed pursuant to Section 502(e)(1)(C) of the Bankruptcy Code. Section 502(e)(1)(C) provides in relevant part, "the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that . . . (C) such entity asserts a right of subrogation to the rights of such creditor under section 509. . . ." The rationale for this is to prevent "double-dipping" by creditors, and to force creditors to elect a remedy with respect to the Debtor. *See United Bank v. Watkins Oil Serv., Inc. (In re Watkins Oil Serv., Inc.)*, 100 B.R. 7, 12 (Bankr. D. Ariz. 1989) ("[the] election, between filing a claim and asserting a right to subrogation, is to prevent a party from receiving more than one recovery. Therefore, if a party has asserted a right to subrogation, the Court should disallow

the claim filed by the party also seeking a right to contribution or reimbursement"); *see also Old Republic Sur. Co. v. Richardson (In re Richardson)*, 193 B.R. 378, 380 (D.D.C. 1995) ("[c]oncededly, [the creditor] has two types of claims: (1) a claim for reimbursement or contribution, and (2) a subrogation claim; and it is clear under the Bankruptcy Code that it cannot have an allowed claim in both categories because that would permit it to effectuate a double recovery"), *aff'd*, 107 F.3d 923 (D.C. Cir. 1997). Thus, to the extent Travelers asserts a right of subrogation, Section 509 of the Bankruptcy Code precludes it from asserting a contingent claim for reimbursement or indemnification with respect to the same obligation.

15. Moreover, pursuant to Section 509(c) of the Bankruptcy Code, to the extent that Travelers asserts claims for reimbursement, contribution or subrogation, such claims are subordinated to the claims of the Obligees for which Travelers is co-liable or has secured, until such creditors are paid in full.[4]

16. The Debtor submits that the Claims should be disallowed in their entirety pursuant to Sections 502(e)(1)(B), 502(e)(1)(C) and Section 509 for the reasons set forth above (and to the extent allowed, should be subordinated pursuant to Section 509(c)).

* * *

---

4. Section 509(c) provides that "[t]he court shall subordinate to the claim of a creditor and for the benefit of such creditor an allowed claim, by way of subrogation under this section, or for reimbursement of contribution, of an entity that is liable with the debtor on, or that has secured, such creditor's claim, until such creditor's claim is paid in full, either through payment under this title or otherwise." 11 U.S.C. §509(c).

Appendix H

G. *To The Extent That The Claims Are Purportedly Filed On Behalf Of The Obligees, They Should Be Disallowed Under Controlling Bankruptcy Law.*

1. *The Claims Should Be Disallowed For Failure To Meet The Requirements Of Federal Bankruptcy Rule 3005 And Bankruptcy Code Section 501(b).*

24. In the Claims, Travelers contends, "[a]lternatively, pursuant to Bankruptcy Code [sic] 501(b), Travelers submits claims for and on behalf of the obligees . . . and all other persons who may have claims against the Debtor based upon which Travelers may become obligated to make any payment and/or incur any expense under the Bonds. These claims are entitled to priority in part pursuant to Bankruptcy Code §507(a)(8)." (Addendum to Travelers Claim Nos. 11335, 8869, 9912, and 9911, ¶7).

25. Although a codebtor is entitled pursuant to Section 501(b) of the Bankruptcy Code to file a claim in the name of the potential creditor, Federal Rule of Bankruptcy Procedure 3005(a) provides that such codebtor must "execute and file a proof of claim in the name of the creditor, if known, or if unknown, in the entity's own name."[5] The Claims have not been executed and filed in the name of the creditors on whose behalf Travelers purportedly filed them. Rather, the Claims

5. Rule 3005(a) provides, in pertinent part, "[i]f a creditor has not filed a proof of claim pursuant to Rule 3002 or 3003(c), an entity that is or may be liable with the debtor to that creditor, or who has secured that creditor, may . . . execute and file a proof of claim in the name of the creditor, if known, or if unknown, in the entity's own name." Fed. R. Bankr. P. 3005.

are expressly executed and filed in the name of Travelers itself, even though Travelers admittedly knows the names of the Obligees, who, according to the Claims, are set forth on Exhibits A and C thereto. Addendum to Travelers Claim Nos. 11335, 8869, 9912, and 9911, ¶7. Thus, Travelers' assertion that it "alternatively, . . . submits claims for and on behalf of the [O]bligees" is insufficient to satisfy Bankruptcy Rule 3005.

26. Moreover, as previously indicated, a claimant has the burden of setting forth all the necessary facts to establish its claim. Travelers has failed to provide supporting documentation so as to establish the Debtor's liability to Travelers with respect to the obligees listed in Exhibit B. Because Travelers has not established the Debtor's liability to Travelers with respect to such obligees, Travelers cannot show that it is a 'codebtor' to the obligees. Accordingly, Travelers is precluded from asserting a claim on such obligees' behalf, pursuant to Bankruptcy Rule 3005 and Section 501(b) of the Bankruptcy Code. Accordingly, to the extent Travelers has failed to provide sufficient documentation with respect to the obligees, including, but not limited to, those listed on Exhibit B, such claims should be disallowed.

2. The Claims Purportedly Filed On Behalf Of The Obligees Should Be Disallowed As Contingent Codebtor Claims For Reimbursement Under Section 502(e)(1)(B).

27. To the extent that Travelers filed the Claims on behalf of Obligees, such claims should be disallowed pursuant to Section 502(e)(1)(B) to the extent that such claims by the Obligees are contingent codebtor claims for

reimbursement and/or contribution. At least two of the bonds identified in the Claims (Bond No. B1686191 in the amount of $100,000,000 and Bond No. 103487592 in the amount of $300,000) (collectively, the "Workers' Compensation Bonds") secure the Debtor's obligation to reimburse the State of California with respect to workers' compensation obligations based on the Debtor's status as a self-insurer. Currently, the Debtor has no outstanding obligations to the State with respect to workers' compensation. Moreover, the Debtor's obligation to reimburse the State would only arise if the Debtor failed to pay its workers' compensation obligations and the State were required to satisfy such obligations itself.

28. Accordingly, the Debtor submits that the Claims purportedly submitted on behalf of the State of California with respect to the Workers' Compensation Bonds satisfy the three elements of Section 502(e)(l)(B) discussed above. First, the claim on behalf of the State would be one for reimbursement. Second, the State is liable with the Debtor on such workers' compensation obligations. Finally, because the Debtor has not defaulted on its workers' compensation obligations, the State's potential claim for reimbursement is contingent.

29. In light of the foregoing, the Debtor requests that to the extent the claims of the Obligees are codebtor claims for reimbursement or contribution, such claims be disallowed in their entirety.

3. *To The Extent That The Claims Purportedly Filed On Behalf Of The Obligees Are Not Disallowed, They Should Be Reclassified As General Unsecured Claims.*

30. To the extent that the Claims purportedly filed on behalf of certain Obligees, are not disallowed, such alleged priority claims should be reclassified as general unsecured claims. As previously indicated, Travelers asserts that such claims are entitled to priority under Section 507(a)(8) of the Bankruptcy Code. However, Travelers has not articulated, let alone established, how the claims of such Obligees are entitled to priority. Accordingly, to the extent the claims on behalf of the obligees are allowed, they should be reclassified as general unsecured claims for the reasons set forth above.

31. The enumeration of specific objections herein is without prejudice to any and all other objections which PG&E may have and which may be asserted with respect to the Claim, including, without limitation, any objections that may be revealed (to the extent applicable) after supporting documentation is provided and after discovery is taken in these proceedings.

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III.

RELIEF SOUGHT.

WHEREFORE, the Debtor prays that this Court enter an order as follows:

A. Sustaining the Objection to the Claims;

B. Disallowing Claim Nos. 9911, 9912 and 11335 as duplicative;

C. Disallowing the Claims, to the extent filed on behalf of Travelers, in their entirety for the reasons set forth herein;

D. To the extent that Travelers' Claims for subrogation are not disallowed in their entirety, subordinating such Claims until the relevant creditors are fully paid;

E. Disallowing the Claims, to the extent filed on behalf of the Obligees, to the extent set forth herein;

F. To the extent the Claims are not disallowed in their entirety reclassifying as them as general unsecured claims; and

G. Granting such other and further relief as the Court deems just and appropriate.

DATED: March 18, 2002.

Appendix H

Respectfully,

HOWARD, RICE, NEMEROVSKI, CANADY, FALK & RABKIN
A Professional Corporation

By: s/ Gary M. Kaplan
GARY M. KAPLAN

Attorneys for Debtor and Debtor in Possession
PACIFIC GAS AND ELECTRIC COMPANY

APPENDIX I — EXCERPTS OF RESPONSE-OF TRAVELERS CASUALTY AND SURETY COMPANY TO DEBTOR'S OBJECTIONS TO TRAVELERS CLAIMS [NOS. 8869, 9911, 9912, AND 11335] FILED MAY 6, 2002

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

Case No. 01-30923 DM
Chapter 11 Case

HEARING:
Date: May 20, 2002
Time: 1:30 p.m.
Place: 235 Pine Street
San Francisco, CA
Judge: Hon. Dennis Montali

In re

PACIFIC GAS AND ELECTRIC COMPANY,
a California Corporation,

Debtor.

Federal I.D. No. 94-0742640

RESPONSE-OF TRAVELERS CASUALTY AND SURETY COMPANY TO DEBTOR'S OBJECTIONS TO TRAVELERS CLAIMS [NOS. 8869, 9911, 9912, AND 11335]

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II. The Debtor May Not Obtain the Disallowance of Travelers' Reimbursement Right; Assuming that the Debtor May Do So, Travelers Elects To Preserve Its Subrogation Right, which Is Not Subject to Disallowance.

The Debtor further objects to Travelers' Proof of Claim on the ground that Travelers has not yet paid anything under its Bonds. The Debtor characterizes Travelers' claims as "contingent reimbursement claims" subject to disallowance under section 502(e)(1)(B) of the Bankruptcy Code. In addition, the Debtor challenges and seeks to eliminate Travelers' subrogation right.

Except for Travelers' claim for attorney's fees (for which the Debtor is contractually liable under its indemnification agreement with Travelers), it is true that Travelers has not yet been called upon to make any payment. Hence, it is true that, at the present time, Travelers is not entitled to a distribution from the Debtor's bankruptcy estate (other than on account of the attorney's fees that it has paid) on account of its reimbursement claim. Travelers, however, may be called upon to make payments in the future under its Bonds. The question is whether the Debtor at this point may permanently eliminate Travelers' right to future recoveries.

Although the Debtor is not presently obligated to make a distribution to Travelers on account of Travelers' reimbursement claim, this does not mean that, under the unusual facts of this case, the Debtor may permanently eliminate Travelers' reimbursement right in the event

Travelers is called upon to make payment in the future. For the reasons discussed below, the Debtor is not entitled to do so in this case.

Assuming that the Debtor may permanently eliminate its reimbursement obligation to Travelers, Travelers still retains its right of subrogation. Under this right, in the event Travelers is ever called upon to make payment under its Bonds, Travelers may assert the claims of the Obligees whom Travelers pays, and Travelers may recover on account of their claims.

A. Travelers Is Entitled to Assert Its Rights of Reimbursement and Subrogation.

The obligation of a surety on its bond is not one of insurance; it is one of secondary liability. *See* 74 Am. Jur. 2d *Suretyship* § 1 (2001) ("The surety's obligation is . . . accessory or collateral to the original obligation contracted by the principal"). Although the Debtor would prefer to treat Travelers Bonds as a form of insurance by eliminating Travelers' recourse to the Debtor for any payments Travelers may make, the Debtor may not do so in this case.

The doctrine of reimbursement permits a surety who performs under its bond to assert a direct claim against the debtor in the surety's own name for all amounts the surety has paid. *See Howco Leasing Corp. v. Alexander Dispos-Haul Sys., Inc. (In re Alexander Dispos-Haul Sys., Inc.),* 36 B.R. 612, 616 (Bankr. D. Or. 1983) (the doctrine of reimbursement or indemnity entitles the surety "to compel the principal debtor to repay immediately all or any part of

the principal debt which the surety has paid"). The right exists independently of any contractual arrangement. *See* 74 Am. Jur. 2d *Suretyship,* § 139-141 (2001); Maurice T. Brunner, *What Statute of Limitations Covers Actions for Indemnity,* 57 A.L.R.3d 833, n.23 (2001). In this instance, Travelers has a contractual reimbursement agreement with the Debtor. Under this agreement, Travelers is entitled to recover directly from the Debtor any amount that Travelers may be required to pay under its Bonds, and likewise any of its costs in preserving its rights. Travelers' right of reimbursement is properly a "claim" against the Debtor.

In contrast, the doctrine of subrogation entitles a performing surety to "step into the shoes" of the obligee whom the surety pays and assert all of the obligees's rights against the debtor in order to recover all amounts that the surety has paid to the obligee. *See Pearlman v. Reliance Ins. Co.,* 371 U.S. 132, 138(1962) (subrogation permits a performing surety to "protect itself by resort to the same securities and same remedies which had been available to the [creditor] for its protection. . . ."); *Allen v. See (In re Simmons),* 196 F.2d 608, 610 (10th Cir. 1952) ("[i]t is well settled that where one secondarily liable is called upon to make good of his obligation and pays the debt, he steps into the shoes of the former creditor [and) becomes subrogated to all the rights of the creditor against the principal debtor, including the security given to secure the debt").[1] In this case,

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1. *See also In re Babcock,* 2 F. Cas. 289, 291 (C.C.D. Mass. 1844) (No. 696) (Story, J.) ("And if the creditor has himself already proved his debt in bankruptcy, the surety will have a right upon payment of the debt to stand in equity as substituted to the rights of

(Cont'd)

Appendix 1

Travelers' right of subrogation exists by operation of law and entitles Travelers to assert the claims of any of the Obligees that it pays to the extent that Travelers is ever required to make payment under its Bonds.

Significantly, unlike its right of reimbursement, Travelers' right of subrogation is not itself a "claim" against the Debtor because it is not a "right to payment." On the contrary, Travelers' right of subrogation is merely and exclusively Travelers' equitable right to *acquire* the "claims" of any of the Obligees whom Travelers pays. *See In re Bessemer Materials, Inc.*, 225 F. Supp. at 318 ("subrogation

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the creditor, and will be entitled to the dividends."); *In re Bessemer Materials, Inc.*, 225 F. Supp. 314, 317 (N.D. Ala. 1963) ("[t]he very nature of subrogation is such that the subrogee stands in the shoes of the creditor whom its pays"). As stated by the Supreme Court, there are "probably . . . few doctrines better established . . . ." *Pearlman*, 371 U.S. at 136-37. In addition to its rights of reimbursement and subrogation, a surety also possesses a right of exoneration. The doctrine of exoneration permits a surety who has not yet performed under its bond to compel the principal obligor to do so. *See generally Sylvester v. Martin (In re Martin)*, 130 B.R. 930, 941 (Bankr. N.D. Ill. 1991) (discussing a surety's right of exoneration); 74 Am. Jur. 2d *Suretyship* § 142 (2001) ("[a]fter the debt for which a surety is liable has become due, he may, without paying or being called on to pay it, file a bill in equity in the nature of a bill quia timet to compel the principal debtor to exonerate him from liability"); J.N. Pomeroy, Jr., *Equity Jurisprudence* § 919 at 1490 (1905) (same). Travelers' right of exoneration is not at issue in these proceedings. Further, a surety may also seek "contribution" from any co-sureties. *See Niagara Fire Ins. Co. v. United* States, 76 F. Supp. 850, 855 (S.D.N.Y. 1948) (discussing difference between right of subrogation and right of contribution).

. . . is merely a form of assignment by operation of law."). Thus, in the context of subrogation, the only "claim" that exists is the claim of an obligee:

> Equitable subrogation is the enforcement of the original claim. It is not a separate claim; it is still the injured person's claim although enforced by another.

Insurance Co. of N. Am. v. United States, 76 F. Supp. 951, 953 (E.D. Va. 1948) (citing United *States v. American Tobacco Co.,* 166 U.S. 468, 474 (1897)); *see also In re Wingspread* Corp., 116 B.R. 915, 926 (Bankr. S.D.N.Y. 1990) (noting that the claim of the creditor and the claim of the co-debtor are "in reality . . . a single debt"), *aff'd,* 145 B.R. 784 (S.D.N.Y. 1992), *aff'd*, 992 F.2d 319 (2d Cir. 1993).

Under the Bankruptcy Code, a surety typically has the right to elect between asserting its right of subrogation or its right of reimbursement. Specifically, section 502(e)(1)(C) typically disallows any reimbursement claim to the extent that the surety elects to assert the claim of its obligee through its right of subrogation. 11 U.S.C. § 502(e)(1)(C). Similarly, section 509(b) (1) (A) typically bars the surety from asserting the claim of an obligee whom the surety has paid if the surety asserts its own reimbursement claim and the reimbursement claim is allowed under section 502. 11 U.S.C. § 509(b)(1)(A). Under this scheme, the election belongs to the surety. *See Travelers Ins. Co. v. Cambridge Meridian Group, Inc. (In re Erin Food Servs., Inc.),* 980 F.2d 792, 803 n.19 (1st Cir. 1992) (recognizing co-debtor's option to elect remedy); *American Universal Ins. Co. v. Dunlap* (*In re*

Microwave Prods. of America, Inc.), 118 B.R. 566, 573-74 (Bankr. W.D. Tenn. 1990) (same); *In re Trasks' Charolais,* 84 B.R. 646, 650 (Bankr. S.D. 1988) (same); *In re Fox,* 64 B.R. 148, 151 (Bankr. N.D. Ohio 1986) (same); *In re Baldwin-United Corp.,* 55 B.R. 885, 895 (Bankr. S.D. Ohio 1985) (same); 124 Cong. Rec. S17,403, S17411 (1978) ("to the extent the claim for such surety or codebtor by way of subrogation is more advantageous, such as where such claim is secured, the surety may elect subrogation under section 509.").

Under section 502(e)(1)(B), in the typical bankruptcy case, if the surety elects to assert its reimbursement option, its claim may be disallowed to the extent that it is "contingent" (e.g., the surety asserts a right of recovery against the debtor for amounts that it has not yet paid). *See* 11 U.S.C. § 502(e)(1)(B) . In the event the surety makes payment in the future, however, it may seek reconsideration of the disallowed portion of its reimbursement claim under section 502(j). *See* 11 U.S.C. § 502(j).[2]

In cases in which the debtor liquidates, the surety's 502(j) rights may be of little or no value because, by the time the surety seeks reconsideration, there may be nothing left to pay its reconsidered claim. Similarly, in "pot plan" cases in which the debtor will only make a percentage distribution to unsecured creditors, the same result may also occur. In rare cases such as this one, however, in which the Debtor is obligated to pay all unsecured claims in full, the surety's

2. In addition, if the surety's claim is secured by property of the debtor, it retains whatever *in rem* lien rights it has notwithstanding the disallowance of its reimbursement claim. *See* 11 U.S.C. § 506(d).

section 502(j) rights should retain their full value. *Cf. In re MCORP Financial, Inc.*, 137 B.R. 219, 225-26 (Bankr. S.D. Tex. 1992) (plan that unduly restricted recovery to be determined after reconsideration of disallowed claim under section 502(j) could not be confirmed). Accordingly, notwithstanding that the Debtor is not presently obligated to make a distribution to Travelers on account of Travelers' reimbursement claim, Travelers should nevertheless retain the value of its future right of recovery.

The Debtor should not be entitled to impair Travelers' rights for yet another reason. As discussed in section VIII *infra,* Travelers maintains that, because the Debtor is solvent, the Debtor is not entitled to permanently cut off Travelers' reimbursement right.

B. Travelers May Elect and Preserve Its Right of Subrogation.

Assuming that the Court disagrees with the foregoing, Travelers still retains its election to pursue its subrogation right. Again, Travelers' right of subrogation is not a "claim" against the Debtor because it does not involve a "right to payment." *See* 11 U.S.C. § 101(5). On the contrary, Travelers' right of subrogation is an equitable right arising between Travelers and the Obligees enabling Travelers to acquire the Obligees' claims against the Debtor in the event Travelers is ever required to make payment to the Obligees. Significantly, because Travelers' subrogation right is not a right against the Debtor, Travelers' subrogation right is not subject to disallowance.

Of course, Travelers cannot recover a present distribution from the Debtor on account of its subrogation right. That is so because, at the present time, the only relevant persons with "claims" against the Debtor are the Obligees (e.g., the injured workers to whom the Debtor owes workers' compensation benefits). If the Debtor does not pay the Obligees' claims and Travelers is required to pay these claims in the future, Travelers is entitled to step into the Obligees' shoes and assert the Obligees' claims and rights against the Debtor to recover any amount that Travelers has paid to the Obligees.

In this case, Travelers' right of subrogation is significant, particularly with respect to Travelers' $100 million workers' compensation bond. The Debtor has rendered the claims of its injured workers unimpaired under its proposed plan. *See* Second Amended Plan of Reorganization, dated April 19, 2002 at 57-58, ¶ 4.21, Second Amended Disclosure Statement, dated April 19, 2002 at 214, ¶ 22. Accordingly, to the extent that the Debtor defaults on its obligation to make benefit payments to these employees in the future, the workers themselves are entitled to full payment under the plan and may assert this right against the Debtor. In this instance, Travelers would be subrogated to that right in the event Travelers is ever required to make payment under its bond.

In acquiring an obligee's claim through subrogation, the law is clear that the surety is entitled to assert all of the obligee's rights:

> by the operation of the doctrine of subrogation, the subrogee becomes the owner of the very rights

> of the individual who suffered injury to his person or property; they are not similar or analogous but identical.

Niagara Fire Ins. Co. v. United States, 76 F. Supp. 850, 855 (S.D.N.Y. 1948); *see also Aetna Cas. & Sur. Co. v. United States,* 170 F.2d 469, 471 (2d Cir. 1948) (claim of injured worker for workers' compensation asserted by surety through subrogation was still the claim of the injured worker); *In re Wingspread Corp.,* 116 B.R. 915, 929 (S.D.N.Y. 1990) (payment by surety does not extinguish claim of obligee; claim remains intact for surety to assert through subrogation). As noted by one court applying section 509 of the Bankruptcy Code:

> Under the doctrine of subrogation, a subrogee is entitled to assert any priority or special right of the subrogor. . . . Indeed, § 509 provides that the co-debtor [surety] is subrogated to the 'creditor's rights,' not just the creditor's claim.

Wingspread, 145 B.R. at 791; *see* also H.R. Rep. No. 95-595 at 358 ("Subsection (a) subrogates the codebtor (whether as a codebtor, surety, or guarantor) to the *rights* of the creditor, to the extent of any payment made by the codebtor to the creditor.") (emphasis supplied).

This rule is fully consistent with over a century of bankruptcy law regarding the general assignment of claims. As the Supreme Court recognized long ago, the general rule in bankruptcy is that the transfer of a claim vest in the transferee all of the substantive rights of the transferor,

including any priority specified under the bankruptcy laws. *See Shropshire, Woodliff & Co. v. Bush*, 204 U.S. 186, 188-89 (1907); *see also Mokava Corp. v. Dolan*, 147 F.2d 340, 344-45 (2d Cir. 1945) (assignee of mortgage entitled to assert all of the rights of the assignor against the bankrupt). On many occasions since *Shropshire*, the Supreme Court has reiterated that subrogation means that the surety is entitled to all of the rights of the subrogor. *See Pearlman*, 371 U.S. at 136-37; *United States v. Munsey Trust Co.*, 332 U.S. 234, 239-42 (1947); *In re Chateaugay Corp.*, 89 F.3d 942, 947 (2d Cir. 1996) ("Subrogation is one of the oldest of equitable doctrines. Under its rule, one 'compelled to pay a debt which ought to have been paid by another is entitled to exercise all the remedies which the creditor possessed against that other'") (citation omitted). Travelers is entitled to no less in this case.[3]

III. The Debtor May Not Obtain the Disallowance of Travelers' Subrogation Right.

The Debtor further objects to Travelers' Proof of Claim on that ground that, "to the extent Travelers asserts subrogation claims, such claims should be disallowed under Sections 502(e) (1) (B) and 509 of the Bankruptcy Code." First, as explained above, Travelers does not assert a

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3. With respect to the attorneys' fees that Travelers had paid in this case (and will pay through confirmation of the Debtor's plan), the Debtor is liable for these as neither a "reimbursement" nor a "subrogation" obligation, but purely as a contractual liability under the Debtor's indemnity agreement with Travelers. These amounts properly form the basis of an ordinary, noncontingent claim against the Debtor.

"subrogation claim." On the contrary, Travelers asserts that it possesses a subrogation right arising between Travelers and each of the Obligees, and that this right entitles Travelers to assert the claims of the Obligees to the extent that Travelers must pay the Obligees at some point in the future.

Second, a subrogation right is not subject to disallowance under section 502(e) (1) (B) . By its terms, this section applies only to contingent reimbursement claims.

Third, a subrogation right is not subject to disallowance under section 509(a). This section is not a disallowance provision. Section 509(a) simply restates the general rule that a surety is subrogated to the extent of its payment, and the debtor is not entitled to convert this affirmative declaration of the surety's subrogation right into a disallowance provision.

Alternatively, assuming that the Court concludes that Travelers' subrogation right is a type of "debt" obligation that the Debtor might otherwise curtail, the Debtor would still be prohibited from doing so under section 524(e) of the Bankruptcy Code. In this instance, the relevant property for purposes of section 524(e) is the Obligees' claims. Under the doctrine of subrogation, Travelers is entitled to take assignment of those claims in the event Travelers pays the Obligees under its Bonds. To the extent that the Court agrees with the Debtor that it can treat Travelers' subrogation right as a debt that it may discharge, nevertheless the Debtor many not thereby extinguish Travelers' right with respect to the property of the Obligees. *Cf. NCNB Texas Nat'l Bank v. Johnson*, 11 F.3d 1260, 1266-69 (5th Cir. 1994) (Section

524(e) prevents discharge from affecting guaranties and implicitly preserves guarantors' defenses against liability).

A. Travelers' Subrogation Right Is Not a Claim Subject to Disallowance Under Section 502(e)(1)(B).

The Debtor repeatedly confuses Travelers' subrogation "right" with the concept of a "claim." The Debtor's efforts to mischaracterize Travelers' subrogation right in order to disallow it, however, are contrary to applicable law.

The Code defines the term "claim" as "a right to payment." 11 U.S.C. § 101(5). Obviously, not all "rights" are "claims." *See Nobelman v. American Say. Bank,* 508 U.S. 324, 326-32 (1993); *United* States v. *LTV Corp. (In re Chateaugay Corp.),* 944 F.2d 997, 1008-09 (2d Cir. 1991) (environmental obligation that could not be reduced to a monetary obligation against the debtor was not a "claim"). Similarly, not all "rights to payment" are rights against the debtor. A right of subrogation is neither a right to payment nor a right against the debtor. Hence, it is not a claim subject to disallowance.

But even if a right of subrogation were a claim, it is still not subject to disallowance under section 502(e)(1)(B). This section is very specific in disallowing only contingent reimbursement claims:

> the court shall disallow any claim for reimbursement or contribution of an entity that is

> liable with the debtor on or has secured the claim of a creditor. . . .

11 U.S.C. § 502(e)(l)(B) (emphasis added).[4]

As the court have long recognized, subrogation and reimbursement are legally distinct rights. *See Jenkins v. National Surety Co.*, 277 U.S. 258, 265 (1928) (judicial determination of subrogation rights does not have preclusive effect on later question of reimbursement rights); *Williams v. United* States *Fid. & Guar. Co.*, 236 U.S. 549, 556 (1915) (distinguishing between reimbursement and subrogation rights); *United States v. Burke (In re Miller)*, 105 F.2d 926, 929 (2d Cir. 1939) (distinguishing between reimbursement and subrogation claims); *Tennant v.* United *States Fid. & Guar. Co.*, 17 F.2d 38, 39 & n.1 (3d Cir. 1927) (bankruptcy

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4. *See* note 1, *supra* (discussing right of contribution). As is relevant here, a claim is "contingent" within the meaning of the Bankruptcy Code if liability for the obligation underlying the claim has not yet accrued because critical element of the obligation that would trigger liability has not yet occurred. *See e.g., In re All Media Properties, Inc.*, 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980) ("claims are contingent as to liability if the debt is one which the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor to the alleged creditor and if such triggering event or occurrence was one reasonably contemplated by the debtor and creditor at the time the vent giving rise to the claim occurred."), *aff'd*, 646 F.2d 193 (5th Cir. 1981). A reimbursement claim asserted by a surety who has not yet performed under its bond is a classic example of a "contingent" claim. *See, id.* 9 (noting the "classic contingent liability of a guarantor of a promissory note"); *In re Lull Corp.*, 162 B.R. 234, 238-39 (Bankr. D. Minn. 1993).

referee erred in concluding that surety had only right of subrogation; surety also had right of reimbursement). Congress was obviously aware of this distinction because it specifically treated contingent reimbursement "claims" in section 502(e)(l)(B), and subrogation "rights" separately in section 509. Section 502(e) and 509 cross-reference each other, and the legislative history illustrates that Congress clearly appreciated the distinction between the concepts of reimbursement and subrogation.[5]

Moreover, the Bankruptcy Code treats rights of reimbursement and subrogation in quite different ways. By its express terms, Bankruptcy Code Section 502(e)(l)(B) directs the disallowance of reimbursement claims that are contingent, but says nothing about subrogation rights. Given the structure and text of the governing statutory scheme, the Debtor cannot interlineate the term "subrogation" into the text of section 502(e)(1)(8). *See Connecticut Nat'l Bank v. Germain,* 503 U.S. 249, 253-54 (1992) ("courts must presume that a legislature says in a statute what it means and means in a statute what it says there."); *Juniper Devel. Group v. Kahn (In re Hemingway Transp., Inc.)* 993 F.2d 915, 924 (1st Cir.) ("Bankruptcy Code § 502(e)(1)(B) obliges a construction consistent with its plain terms."); *The Leslie Fay Cos., Inc. v. Corporate Prop. Assoc. (In re The Leslie*

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5. *See* 124 Cong. Rec. S17,403, S17410 (1978) (noting that Section 502(e) allows a surety to make a choice between its remedies: "to the extent a claim for . . . reimbursement would be advantageous . . . a surety . . . may opt for reimbursement . . . under Section 502(e). . . . to the extent the claim for such surety . . . by way of subrogation is more advantageous . . . the surety may elect subrogation under Section 509. . . .").

Fay Cos., Inc.), 166 B.R. 802, 810 (Bankr. S.D.N.Y. 1994) (had Congress intended to include grounds for disallowance in § 502 other than those set forth it would have "provided so expressly, most probably by including another subsection"); *Al Tech Specialty Steel Corp. v. Allegheny Int'l, Inc. (In re Allegheny Int'l, Inc.),* 126 B.R. 919, 921-22 (W.D. Pa.) (interpreting § 502(e) by its plain meaning), *aff'd,* 950 F.2d 721 (3d Cir. 1991).

B. Travelers' Subrogation Right Is Not Subject to Disallowance Under the Ninth Circuit's Test For Applying Section 502 (e) (1) (B) .

Interpreting section 502(e)(1)(B) as it is written, the Ninth Circuit has adopted a clear test for its application: "A claim will be disallowed under § 502(e)(1)(B) only if (1) the claim is *for reimbursement* or *contribution*; (2) the party asserting the claim is liable with the debtor on the claim of a creditor; and (3) the claim is contingent at the time of allowance or disallowance." *Dant & Russell, Inc. v. Burlington Northern Railroad Co. (In re Dant & Russell, Inc.),* 951 F.2d 246, 248 (9th Cir. 1991) (emphasis supplied). To state this test is to demonstrate the inapplicability of Section 502(e)(1)(B) in this matter because Travelers' "subrogation right" is clearly not a claim for reimbursement or contribution. The text of Section 502(e)(1)(B) is unambiguous and there is no reason to believe that Congress intended to include subrogation rights within its scope.

Furthermore, Section 502(e)(1)(B) only disallows *contingent* claims, and Travelers' subrogation right is *not* contingent. Travelers' subrogation right is a presently existing

right that Travelers has to acquire the claims of the Obligees by paying the Obligees at some point in the future. For each of these reasons, section 502(e)(l)(B) does not apply.[6]

C. Disallowing Travelers Subrogation Right Would Not Serve any of the Purposes of Section 502(e)(1)(B).

As explained by one court, the primary purpose of Section 502(e)(1)(B) is the avoidance of the problem of "double-dipping":

> The sole purpose served by section 502(e)(1)(B) is to preclude redundant recoveries on identical claims against insolvent estates. . . . The 'double-

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6. Although somewhat confusing, the Second Circuit's decision in *Aetna* Casualty & *Surety Co. v. Georgia Tubing Corp.*, 93 F.3d 56 (2d Cir. 1996), does not support the Debtor's arguments in this case. At issue in *Georgia Tubing* was the debtor's liability to the surety for future clean-up costs under an environmental bond that the surety issued to the State of Georgia on the debtor's behalf before the debtor filed for bankruptcy. In considering whether the debtor would be liable to reimburse the surety for any amounts that the surety might pay in the future, the court unfortunately conflated the concepts of "reimbursement" and "subrogation." Nevertheless, the court clearly concludes that the surety will be entitled to recover from the debtor in full in the event the surety is ever required to make payment under its bond in the future: "If, as Aetna apprehends, Georgia Tubing should incur environmental liabilities to Georgia when its facility is closed sometime in the future, and if Aetna is then called upon to pay Georgia with respect to such liabilities, nothing in the order we affirm today bars whatever reimbursement claims Aetna might then have." *Id.* at 57.

> dipping' threat in the present case would result from the allowance and estimation of [the co-debtor's] contingent claim, and the allowance of [the creditor's] claim, for the same future claim] against the chapter 7 estate.

In re Hemingway Transp., Inc., 993 F.2d at 923. As *Hemingway* makes clear, the problem of "double-dipping" occurs when a creditor and a surety each assert a separate claim for the same liability. That problem arises, however, only in the context of contingent reimbursement and contribution claims.[7] In contrast, "double-dipping" does not arise in the context of a subrogation right because there is no possibility that both the obligee and the surety will recover (or even seek to recover) twice on the same liability. Again, that is because, through subrogation, the surety and the creditor share the *same* claim, not two separate claims.

In addition, the *Hemingway* court identified a second (and closely parallel) goal of Section 502(e)(1)(B): "Section 502(e) (1) (B) was enacted . . . 'to prevent[] *competition*

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7. By way of illustration, suppose a surety has guaranteed in full the debtor's payment of a $100 note to a creditor. Suppose the debtor is insolvent and files for bankruptcy relief having paid nothing on the note. The creditor may file a claim for $100. Suppose further that the surety has not paid the creditor on its guaranty. Under these facts, the surety would hold a contingent $100 claim for reimbursement against the debtor (contingent upon the surety's payment under the guaranty). Permitting the surety to recover on its claim in addition to permitting the creditor to recover would result in "double-dipping" – the payment of two $100 claims asserted by two separate entities against the debtor for the same liability.

between a creditor and his guarantor for limited proceeds of the estate.'" *In re Hemingway Transp., Inc.*, 993 F.2d at 923 (quoting H.R. Rep. No 595, 95th Cong., 1st Sess. 354 (1977); S. Rep. No 989, 95th Cong., 2d Sess. 65 (1977) (emphasis in original)). In most bankruptcy cases, the debtor typically lacks the wherewithal to satisfy all claims in full. Obviously, if the surety who has not yet paid on its bond could assert a contingent reimbursement claim directly against the debtor, and the creditor could do so as well for the same liability, the surety and creditor would stand in competition with each other for potentially limited dividends. Section 502(e)(1)(B) operates to disallow the contingent reimbursement claim of the surety to prevent that from happening.

However, the very nature of subrogation will not permit a similar result. Travelers and the obligees can only share the *same* claim, and Travelers' interest in the claims is subordinate to that of the obligees. *See* 11 U.S.C. § 509(c). This comports with the purpose of subrogation: the surety merely asserts the creditor's claim. Thus, there is only one claim to allow and one claim to pay regardless of its holder. Therefore, the possibility that Travelers will "compete" with the obligees for the same assets of the Debtor simply cannot exist. *See In re Chateaugay Corp.*, 155 B.R. 625, 634 (Bankr. S.D.N.Y. 1993), *aff'd*, 177 B.R. 176 (S.D.N.Y. 1995) (recognizing surety's right of subrogation to workers' payment rights arising pre-petition).

Appendix I

D. Travelers' subrogation Right Is Not Subject to Disallowance Under Section 509(a).

Travelers subrogation right is similarly not subject to disallowance under section 509(a) because this section is not a disallowance provision. On the contrary, the section merely reaffirms the general rule of subrogation that "an entity that is liable with the debtor on, or that has secured, a claim of a creditor against the debtor, and that pays such claim, is subrogated to the rights of such creditor to the extent of such payment." 11 U.S.C. § 509(a). Further, there is no basis to convert section 509(a) into a disallowance provision. Section 509(a) contains no temporal restriction, and, under the section, the surety is entitled to be subrogated to the rights of its obligee *whenever* it is called upon to make payment to the obligee. *See Pandora Indus., Inc. v. Paramount Communication Inc., (In re Wingspread Corp.),* 145 B.R. 784, 791 (S.D.N.Y. 1992) (holding that the surety in question was entitled to be subrogated to the benefit of the creditor's rights arising after the debtor filed for bankruptcy relief as a result of the debtor's postpetition assumption of a lease).

The right of subrogation is central to the suretyship relationship, and is fundamental to the nature of Traveler's undertaking:

> That privilege was a necessary incident to petitioner's contract, for only by resort to it could the character of the contract as indemnity be preserved. It is both the object and the justification of subrogation that it makes exact indemnity the measure of liability.

Aetna Gas. & Sur. Co. v. Phoenix Nat. Bank & Trust Co., 285 U.S. 209, 214 (1932); *see also Bessemer,* 225 F. Supp. at 317-18 ("Contract prices and surety premium rates are regulated in the overall scheme of the business world to reflect this valuable [subrogation] right of parties assuming secondary liabilities."). If Congress had intended section 509(a) to constitute a disallowance provision, it would have said so expressly. Moreover, construing section 509(a) as a disallowance provision would simply generate a windfall to the Debtor by permitting the Debtor to destroy Travelers' recourse even though the Debtor remains fully obligated on any underlying debt to the Obligees.

Reference to section 509(b) also refutes the Debtor's construction of section 509(a) as a disallowance provision. Section 509(b) operates expressly to disallow a right of subrogation in a very narrow range of circumstances, none of which are present here. Similarly, section 507(d) bars subrogation in certain enumerated settings, none of which apply in this case. If Congress had intended to disallow a right of subrogation in cases such as this one for the reasons stated by the Debtor, Congress could have done so expressly. Congress' election not to bar subrogation in cases such as this one is conclusive, and the Debtor cannot create a further barrier to subrogation where it does not exist. *See In re Chateaugay Corp.*, 89 F.3d 942, 948 (2d Cir. 1996) (obligation to make payment in the future is sufficient to entitle surety to be subrogated when it pays); *Wingspread*, 145 B.R. at 791 (the Code's express statutory limitations on surety's right of subrogation demonstrates the breadth of Section 509(a) in contexts in which sections 507(d) and 509(b) do not apply). Accordingly, Travelers' claims cannot be disallowed under section 509.

* * * *

APPENDIX J — STIPULATION RESOLVING DEBTOR'S OBJECTIONS TO CLAIMS OF TRAVELERS CASUALTY AND SURETY COMPANY [CLAIMS NOS. 8869, 9911, 9912, AND 11335]; ORDER THEREON FILED NOVEMBER 8, 2002

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

No. 01-30923 DM

Chapter 11 Case

JUDGE: Hon. Dennis Montali

HEARING:
DATE: November 8, 2002
TIME: 1:30 p.m.
PLACE: 235 Pine Street, 22nd Floor
San Francisco, California

In re

PACIFIC GAS AND ELECTRIC COMPANY,
a California corporation,

Debtor.

Federal I.D. No. 94-0742640

STIPULATION RESOLVING DEBTOR'S OBJECTIONS TO CLAIMS OF TRAVELERS CASUALTY AND SURETY COMPANY [CLAIMS NOS. 8869, 9911, 9912, AND 11335]; ORDER THEREON

Appendix J

* * *

STIPULATION RESOLVING DEBTOR'S OBJECTIONS TO CLAIMS OF TRAVELERS CASUALTY AND SURETY COMPANY [CLAIMS NOS. 8869, 9911, 9912, AND 11335]; ORDER THEREON

This Stipulation is entered into by and between Pacific Gas and Electric: Company, the debtor and debtor in possession in the above-referenced bankruptcy case ("PG&E" or "Debtor") and Travelers Casualty and Surety Company of America and Travelers Casualty and Surety Company as Administrator for Reliance Surety Company (1) for itself, (2) as successor in interest by merger with United Pacific Insurance Company, and (3) for related Reliance Insurance companies (collectively "Travelers") as follows:

A. On April 6, 2001 (the "Petition Date"), PG&E filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 101 et seq., in the above-captioned Court.

B. Since the Petition Date, the Debtor has continued to operate its businesses and manage its properties as a debtor in possession pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code.

C. Prior to the Petition Date, Travelers issued various surety bonds (the "Surety Bonds") to various third parties on behalf of the Debtor assuring the Debtor's performance of various obligations, including, without limitation, the Debtor's provision of certain workers' compensation benefits under applicable state law.

D. On or about September 5, 2001, Travelers filed a certain proof of claim assigned Claim No. 8869 on behalf of:

(a) Travelers Casualty and Surety Company of America and Travelers Casualty and Surety Company as Administrator for Reliance Surety Company (1) for itself, (2) as successor in interest by merger with United Pacific Insurance Company, and (3) for related Reliance Insurance companies; and

(b) various obligees of the Surety Bonds and all other persons who may have claims against the Debtor based upon which Travelers may become obligated to make payment and/or incur expense under the Surety Bonds (collectively, the "Travelers' Claims").

E. At the rime Travelers filed its proof of claim form for the Travelers Claims, the noticing agent apparently recorded copies of Travelers' proof of claim form as separate claims bearing Claim Nos. 9911, 9912, and 11335 (collectively, the "Duplicate Claims") (The Duplicate Claims and the Travelers Claims are collectively referred to herein as the "Claims").

F. As set forth in the Travelers' Claims, in conjunction with the issuance of the Surety Bonds, the Debtor executed a certain Continuing Agreement of Indemnity dated June 11, 1992, and a certain Continuing Agreement of Indemnity dated June 6, 1991 (the "Indemnity Agreements").

G. Pursuant to the Indemnity Agreements, the Debtor is obligated to indemnify Travelers for certain losses that Travelers may incur as a result of, or in connection with, its issuance of certain of the Surety Bonds, including certain attorneys fees.

H. In addition, as set forth in the Travelers' Claims, PG&E Corporation ("PG&E Corp.") executed a certain Specific Indemnity Agreement dated April 7, 2000, pursuant to which PG&E Corp. is obligated to indemnify Travelers with respect to certain losses that Travelers may incur as a result of its issuance of a certain workers' compensation bond (the "Parent Indemnity")

I. Other than its attorneys' fees, Travelers has not been called upon to satisfy any of the obligations assured by, or to make any payment under, any of its Surety Bonds or with respect to the Indemnity Agreements.

J. In the future, Travelers may be obligated to perform certain obligations, or to make payments, with respect to one or more of the Surety Bonds.

K. On or about March 18, 2002, the Debtor filed an objection to the Claims (the "Objection").

L. By this Stipulation, PG&E and Travelers seek to fully resolve all objections to the Claims without further litigation as provided herein, and to that end the parties hereby stipulate and agree as follows:

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1. The Duplicative Claims (Claim Nos. 9911, 9912, and 11335) are hereby disallowed in their entirety as duplicative of Claim No. 8869, leaving only Claim No. 8869.

2. With respect to Claim No. 8869, other than Travelers' claim for attorneys' fees (which is discussed below), Travelers has not been called upon to satisfy any of the obligations assured by, or to make any payment with respect to, any of its Surety Bonds or the Indemnity Agreements.

3. Accordingly, except as provided herein with respect to Travelers' claim for attorneys' tees and subject to the provisions hereof, Claim No. 8869 is hereby disallowed pursuant to Section 502(e)(1)(B) of the Bankruptcy Code.

4. Claim No. 8869 is further disallowed to the extent that PG&E and Travelers have no liability on certain of the Surety Bonds (based upon, among other things, all liability being extinguished by the obligees under any such Surety Bond, or under the terms of any such Surety Bond).

5. The disallowance of Claim No. 8869 is without prejudice to (i) Travelers' right to seek reconsideration of the disallowance of Claim No. 8869 under Section 502(j) of the Bankruptcy Code in the event Travelers satisfies, or is obligated to make payment with respect to, any of the Surety Bonds or in connection with the Indemnity Agreements; or (ii) PG&E's right to oppose any such reconsideration.

6. Nothing herein shall affect or impair whatsoever the Parent Indemnity.

7. Nothing herein shall prejudice or impair Travelers' subrogation rights under applicable law, or the Debtor's right to object to Travelers' asserted subrogation rights.

8. To the extent that Travelers is subrogated to the claim of any obligee under any of its Surety Bonds, Travelers shall hold such claim as a general unsecured creditor, provided that, to the extent that the claim in, the hands of the obligee is entitled to priority, Travelers shall be entitled to the same priority with respect to such claim, except as provided in section 507(d) of the Bankruptcy Code.

9. Subject to the right of a party in interest to object as provided herein, Travelers may assert its claim for attorneys' fees under the Indemnity Agreements as a general unsecured claim against PG&E as follows:

a. Travelers shall file an amended claim setting forth the amount of its asserted attorneys' fees within sixty days of the date the Court's order approving this Stipulation, which amended claim shall include all attorneys' fees incurred through such date, and shall serve such amended claim on counsel for PG&E, the Creditors' Committee, and the United States Trustee.

b. PG&E, the Creditors' Committee, the United States Trustee, or other party in interest, shall file any objection to Travelers' claim for attorneys' fees within sixty days of the filing and service thereof, and, subject to Travelers' right to reply to any such objection(s), the Court shall resolve any such objection(s) absent settlement by the parties.

c. In the event PG&E, the Creditors' Committee, the United States Trustee, and any other party in interest do not object to such claim for attorneys' fees, the amount asserted shall be allowed and paid as a general unsecured claim in PG&E's bankruptcy case.

d. The allowance of Travelers' attorneys' fees, if any, pursuant to the foregoing shall be without prejudice to (i) Travelers' right, if any, to assert and recover additional attorneys fees incurred after the filing of its amended claim in connection with and to the extent that PG&E shall thereafter object to or challenge Travelers' asserted rights, if any, under the Surety Bonds or the Indemnity Agreements, or PG&E shall impair under any confirmed plan of reorganization the workers' compensation claims of any person covered by any of Travelers' Surety Bonds; or (ii) the right of PG&E, the Creditors' Committee, the United States Trustee, or any other party in interest, to object to any such additional claimed attorneys fees.

10. The Debtor and Travelers may agree to a list of obligations covered by the Surety Bonds as to which the Debtor's and Travelers' liability has been extinguished by operation of law or otherwise and may file such list with the Court in connection with a further stipulation, in which event any claim asserted by Travelers under Section 501(b) with respect to such liability shall be disallowed. Nothing herein shall prevent the Debtor from specifically objecting to any claim asserted under Section 501(b), in which event Travelers shall be given notice of such objection.

Appendix J

Dated: November 8, 2002 TRAVELERS CASUALTY & SURETY COMPANY

By s/ G. Eric Brunstad, Jr.
BINGHAM McCUTCHEN LLP
G. ERIC BRUNSTAD, JR.
One State Street
Hartford, Connecticut 06103-3178
Telephone: (860) 240-2700
Facsimile: (860) 240-2800

Counsel for Travelers Casualty & Surety Company of America

Dated: November 8, 2002 PACIFIC GAS AND ELECTRIC COMPANY

By s/ Gary M. Kaplan
Gary M. Kaplan
Title: Howard, Rice, Nemerovski, et al.
Attorneys for Pacific Gas and Electric Company

Based upon the foregoing Stipulation, and good cause appearing therefore, it is SO ORDERED.

Dated: NOV 08 2002

s/ Dennis Montali
HONORABLE DENNIS MONTALI
UNITED STATES BANKRUPTCY JUDGE

Appendix J

Proof Of Claim
Dated January 3, 2003
[*See* Supplemental Joint Appendix]

APPENDIX K — EXCERPTED NOTICE OF OBJECTION AND OBJECTION TO AMENDED CLAIM OF TRAVELERS CASUALTY & SURETY CO., ET AL DATED APRIL 28, 2003 AND FILED MARCH 7, 2003

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

Case No. 01-30923 DM

Chapter 11 Case

Date: April 28, 2003
Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California

In re

PACIFIC GAS AND ELECTRIC COMPANY,
a California corporation,

Debtor.

Federal I.D. No. 94-0742640

NOTICE OF OBJECTION AND OBJECTION TO AMENDED CLAIM OF TRAVELERS CASUALTY & SURETY CO., ET AL.

* * *

Appendix K

3. Travelers' Amended Claim Seeks Recovery Of Amounts That Are Not Compensable Under The Indemnity Agreements And The Stipulation, Are Not Reasonable And Are Not Recoverable As A Matter Of Bankruptcy Law.

Even if Travelers could assert a valid claim for attorneys' fees and had properly set forth such claim, the Amended Claim should nevertheless be disallowed because it asserts a claim for attorneys' fees and other expenses that are not recoverable under the Indemnity Agreements, the Stipulation and applicable bankruptcy law, as discussed in greater detail below.

a. The Attorneys' Fees Sought Are Not Recoverable Under the Indemnity Agreements And The Stipulation.

As a threshold matter, the attorneys' fees sought by Travelers in the Amended Claim are not compensable under the Indemnity Agreements. The Indemnity Agreements (copies of which are attached to the Amended Claim) provide that PG&E agrees "[t]o indemnify, and keep indemnified and hold and save harmless [Travelers] against all demands, claims, loss, costs, damages, expenses and attorneys' fees whatever, and any and all liability therefore, sustained or incurred by [Travelers] *by reason of executing or procuring the execution of*" certain surety bonds (emphasis added).

Travelers has not asserted, let alone established, that the attorneys' fees sought in the Amended Claim arose from the execution or procurement of the execution of the subject

surety bonds. Indeed, the Amended Claim simply attaches a list of attorneys' fees and costs totaling over $167,000.00, with no explanation other than that the fees arise "under the Indemnity Agreements." Based on Travelers' failure to articulate any basis upon which the attorneys' fees and expenses claimed in the Amended Claim fall within the Indemnity Agreements, the Amended Claim should be disallowed in its entirety.

Moreover, even if Travelers establishes that some of the claimed attorneys' fees are compensable under the Indemnity Agreements, certain fees plainly fall outside of its scope. For example, the Amended Claim asserts a claim for attorneys' fees in the thousands of dollars for research and drafting related to "constitutional arguments" and "constitutional aspects" of the PG&E bankruptcy case. By no stretch of the imagination were such fees sustained or incurred by Travelers "by reason of executing or procuring the execution of" the subject surety bonds.

Furthermore, Travelers' claim for recovery of costs, aggregating $28,462.38 should be disallowed in its entirety because such amounts are not permitted under the Stipulation. The Stipulation (paragraph 9) expressly limits Travelers to "assert[ing] its claim for attorneys' fees under the Indemnity Agreement" and otherwise disallows the Original Claims in their entirety.

b. Certain Of The Attorneys' Fees Are Unreasonable.

Even if some of the claimed attorneys' fees and other expenses are potentially recoverable under the Indemnity Agreements and the Stipulation, they should be disallowed to the extent that they are not reasonable. Some of the claimed charges are patently false. For example, the Amended Claim includes fees incurred by T. Tymchenko in the amount of $1,134.00[3] (5.4 hours) for an April 2, 2002 telephone conversation with Gary M. Kaplan, an attorney for the Debtor. *See* Bingham Invoice No. 55781 (copy attached hereto as Exhibit 3). As reflected in the fee application previously submitted to and approved by this Court, the length of that conversation was merely 0.2 hours. *See* Time Records Exhibit For The Period April 1, 2002 — April 30, 2002 (Howard, Rice, Nemerovski, Canady, Falk & Rabkin) (Docket No. 10120) (copy of relevant pages attached hereto as Exhibit 4).

The Amended Claim also includes tens of thousands of dollars of travel time by Travelers' attorneys. For example, T. Tymchenko billed 10 hours on December 3, 2001 for "[t]ravel to San Francisco for attendance of status conference regarding disclosure statement" at a cost of $1,750.00. *See* Bingham Invoice No. 540897 (copy attached hereto as Exhibit 5). In addition to the 5.5 hours ($962.50) that Ms. Tymchenko has billed for her "return to Hartford from status

3. The Invoices suggest that Bingham provided Travelers a 10% discount on the referenced attorneys' fees. As such, 90% of the time referenced has actually been billed and asserted in the Amended Claim.

conference" on December 4, 2001 is a separate entry the next day of 10 hours ($1,750.00) for her "return to Hartford from status conference." *Id.* Even giving Ms. Tymchenko the benefit of the doubt by assuming that her flight spanned two calendar days, it is unreasonable that the Debtor's estate should pay for 15.5 hours of return travel time, or that Travelers sent two attorneys from the East Coast (Mr. Brunstad's time for this hearing is also included in the Amended Claim) for this hearing. *Id.*

Furthermore, it is not reasonable for Travelers' counsel to fly coast-to-coast to attend hearings in this case in view of this Court's practice of permitting telephonic appearances, and the availability of instructions for doing so on the Court's website. There was certainly no need for Mr. Brunstad to personally attend the November 8, 2002 hearing where this Court was merely asked to approve the previously agreed upon Stipulation, for which he billed a total of 18.2 hours ($10,283.00), including 22 hours ($880.00) to "[p]repare for and attend hearing approving stipulation resolving objection to Travelers' claim" (Bingham Invoice No. 581586 (copy attached hereto as Exhibit 6)) where the record reflects that Mr. Brunstand was present at the hearing for only a few minutes. *See* Transcript of Proceedings held in this Court at 1:30 p.m. on November 8, 2002 (copy of relevant pages attached hereto as Exhibit 7). Moreover, the amount of the charges for such time are inconsistent with the professional fee standards set by the Court in this case. *See, e.g.*, *Memorandum Decision Regarding Applications For Interim Compensation Of Professionals*, entered by this Court on December 12, 2001 (the "Compensation Order") ("the court will not allow any of the portions of the applications that

included airplane travel time"). While the Debtor recognizes that the Compensation Order is not binding on the attorneys hired by Travelers, it should nonetheless serve as a guide in the determination of the reasonableness of fees.

The Debtor estimates that at least $50,000.00 of the claimed attorneys' fees are unreasonable. In addition, much of the expenses for which Travelers seeks recovery are unreasonable, including thousands of dollars of travel expenses and electronic research.

c. Virtually All Of The Attorneys' Fees And Related Expenses Are Not Reimbursable, As They Are Purely Bankruptcy-Related.

Even if some of the claimed attorneys' fees and costs are potentially recoverable under the Indemnity Agreements and Stipulation and are not unreasonable, it is well established in the Ninth Circuit that creditors may not recover fees for purely bankruptcy-related expenses. *See, e.g., In re Elmer Fobian*, 951 F.2d 1149 (9th Cir. 1991) ("where the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law, attorney's fees will not be awarded absent bad faith or harassment by the losing party"); *Renfrow v. Draper*, 232 F.3d 688 (9th Cir. 2000) ("attorney's fees should be awarded solely to the extent they were incurred in litigating state law issues").

Virtually all of the attorneys' fees claimed by Travelers should be denied on this basis. For example, the Amended Claim includes substantial attorneys' fees for reviewing and

objecting to the Chapter 11 plans and related disclosure statements proposed by the Debtor and the California Public Utilities Commission. These are purely bankruptcy-related expenses and should be disallowed under controlling law.

d. The Attorneys' Fees And Related Expenses Should Be Disallowed Pursuant To Section 502(e)(1)(B) of the Bankruptcy Code.

To the extent that any of the attorneys' fees and other expenses claimed by Travelers are not disallowed on the grounds set forth above, they should be disallowed pursuant to Section 502(e)(1)(B) of the Bankruptcy Code to the extent that they are based on contingent reimbursement claims with respect to obligations for which Travelers is co-liable with the Debtor. As discussed above, the basis for the Amended Claim is unclear from its face or the Invoices provided by Travelers. Nevertheless, the Amended Claim apparently seeks recovery of attorney fees incurred with respect to contingent reimbursement claims. Section 502(e)(l)(B) provides that a bankruptcy "court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that," such claim is, "contingent as of the time of [its] allowance or disallowance." 11 U.S.C. § 502(e)(1)(B). Like the Original Claims, the Amended Claim should be disallowed pursuant to this provision to the extent it is similarly based on Travelers' contingent reimbursement claims with respect to claims for which Travelers asserts that PG&E is co-liable. *See, e.g., In re The Drexel Burnham Lambert Group, Inc.*, 146 B.R. 92, 97 (S.D.N.Y. 1992) ("[t]he interdependence between appellant's defense costs and the underlying action

for indemnification places all of the appellant's claims under the umbrella of § 502(e)(1)(B), and thus all claims are disallowed under that subsection"); *In re Wedtech Corp.*, 85 B.R. 285 (Bankr. S.D.N.Y. 1988) (same).

CONCLUSION

WHEREFORE, the Debtor prays that this Court enter an order:

A. Sustaining the Objection to the Amended Claim;

B. Disallowing the Amended Claim in its entirety; and

C. Granting such other and further relief as this Court deems just and appropriate.

DATED: March 7, 2003.

Respectfully,

HOWARD, RICE, NEMEROVSKI, CANADY, FALK & RABKIN
A Professional Corporation

By: s/ Gary M. Kaplan
GARY M. KAPLAN

Attorneys for Debtor and Debtor in Possession
PACIFIC GAS AND ELECTRIC COMPANY

APPENDIX L — LETTER FROM G. ERIC BRUNSTAD, JR. OF BINGHAM McCUTCHEN TO GARY M. KAPLAN OF HOWARD, RICE, ET AL. DATED MAY 11, 2003

G. Eric Brunstad, Jr.
Direct Dial: 860.240.2717
E-Mail: eric.brunstad@bingham.com

May 11, 2003

VIA TELECOPIER

Gary M. Kaplan, Esq.
Howard, Rice, Nemerovsky, Canady,
Falk & Rabkin
Three Embarcadero Center, 7th Floor
San Francisco, California
94111-4024

Re: In re Pacific Gas & Electric Company, Case No. 01-30923 DM

Dear Gary:

Per your request, we have broken down our bills into four different categories. The first (Exhibit A) includes the time spent in connection with the disclosure statement, including objecting to the disclosure statement and responding to the debtor's pleadings. The second (Exhibit B) includes the time spent in connection with the plan, including objecting to the plan and responding to the debtor's pleadings. The third (Exhibit C) includes the time spent in connection with our proof of claim, including the debtor's objections to our claim and our responses to the objections.

Appendix L

The fourth (Exhibit D) includes the time spent in connection with general case management and miscellaneous case administration. In addition, as you also requested, this letter also sets forth succinctly the basis why the debtor is and should be liable for our fees.

As you are aware, Travelers has issued a $100 million surety bond assuring the debtor's performance of its workers' compensation obligations. You may recall that we initially objected to the disclosure statement because neither it nor the plan made specific provision for the treatment of workers' compensation obligations. This was of considerable concern for two reasons. First, if the debtor did not pay its workers' compensation obligations, it would likely loose its self-insured status under applicable state law. As a result, at some point the debtor would be required to purchase workers' compensation insurance, which generally costs about four times the expense of a surety bond. Second, from Travelers' perspective, the treatment of the workers' compensation claims had to be specified because, in the event Travelers ever had to make payment under its bond, Travelers would be entitled to be subrogated to whatever treatment the workers were entitled to receive under the plan.

At the hearing on the disclosure statement, we pursued our objection and explained the above-referenced points. After we made our argument, the Court agreed that the parties should step outside the courtroom and resolve the treatment of the workers' compensation claims and Travelers' rights. We were able to do this, and announced our settlement to the Court. Specifically, we agreed that the plan would provide that the claims of the workers entitled to workers'

compensation would be rendered unimpaired (meaning that they would be paid in full as and when they came due). We also agreed that the plan would leave unimpaired any right that Travelers would have to be subrogated to the claims of the workers in the event Travelers were ever called upon to make payment under its bond. As agreed, this negotiated language appeared in the next version of the amended plan and, from Travelers' perspective, we were essentially done with the case.

Unfortunately, in a subsequent round of plan amendments, the debtor unilaterally elected to alter the negotiated language and provide that it reserved the right to object to Travelers' subrogation rights. In addition, the debtor filed an objection to our proof of claim, contending that Travelers had no subrogation rights. As a result, Travelers was forced to defend its rights.

Travelers' subrogation rights are state law rights. Travelers' subrogation rights mean simply that, in the event Travelers is ever required to make payment under its bond, it is entitled to recover what it has paid by asserting the rights of the claimants whom Travelers has paid. Thus, if Travelers ever has to make payment under its bond to a specific worker covered by the bond, Travelers would then be entitled to step into the worker's shoes and assert the worker's rights against the debtor. Subrogation is nothing more than a right that arises between Travelers and the worker incident to Travelers' bond giving Travelers the right to assert the worker's claim in the event Travelers' pays the worker. In other words, it is nothing more than the right to take assignment of the worker's claim against the debtor if Travelers ever pays the worker.

Appendix L

Significantly, Travelers does not contend that, having not paid anything under its bond, it is entitled to a distribution from the debtor at this time. Quite to the contrary, at the present time it is the workers who are entitled to payment presently. It is only if the debtor were to default in the future and Travelers had to step in to pay the claims that Travelers would be entitled to assert the workers' rights against the debtor.

Quite clearly, Travelers had to object to the disclosure statement and its objection was fruitful not only for Travelers but also for the debtor in so far as the treatment of the workers' compensation claims was resolved. Following the debtor's unilateral modification of the plan, however, Travelers also had to respond to the debtor's efforts to cut off Travelers' subrogation rights by objecting to the debtor's alleged right to do so, which included an objection to the plan. These rights are valuable, and it is Travelers' position that the debtor has no basis for eliminating them. Travelers also had to defend its proof of claim because the debtor objected to the claim on the theory that the debtor could eliminate Travelers' subrogation rights. Further, Travelers has incurred expenses in monitoring the case.

As you know, the debtor executed an indemnity agreement with Travelers. Under the terms of the indemnity agreement, the debtor is responsible for paying all attorneys fees that Travelers has incurred in defending its rights, including its state law subrogation rights. I must reiterate that the vast majority of Travelers' expenses would have been avoided if the debtor had simply adhered to the negotiated language that was originally included in the plan. Indeed, it was the

debtor's election to modify the language and object to Travelers' rights that caused Travelers to incur the vast majority of the expenses set forth in billings. Given the debtor's decision to unilaterally modify the negotiated language and cause Travelers to incur additional legal expenses, it would be patently unfair for the debtor now to object to the payment of Travelers' legal bills.

You have specifically objected to certain expenses, and the attached billing statements reflect adjustments in response to these objections. In addition, Travelers has authorized me to accept a ten percent discount in settlement of this matter with the debtor. Please advise.

Sincerely,

s/ G. Eric Brunstad, Jr.
G. Eric Brunstad, Jr.

APPENDIX M — EXCERPTED TRANSCRIPT OF PROCEEDINGS — OBJECTION TO AMENDED CLAIM OF TRAVELERS CASUALTY & SURETY COMPANY, et al. DATED JULY 11, 2003

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
(SAN FRANCISCO DIVISION)

Case No. 01-30923 DM

Chapter 11

San Francisco, California
July 11, 2003
1:29 p.m.

In re:

PACIFIC GAS AND ELECTRIC COMPANY,
a California Corporation,

Debtor.

TRANSCRIPT OF PROCEEDINGS
OBJECTION TO AMENDED CLAIM OF TRAVELERS CASUALTY & SURETY COMPANY, et al.

BEFORE THE HONORABLE DENNIS MONTALI
UNITED STATES BANKRUPTCY JUDGE

[Commencing at page 21]

* * *

MR. BRUNSTAD: To the extent Travelers asserts a right of subrogation, such claims are for prospective subrogation —

THE COURT: Yeah, prospective.

MR. BRUNSTAD: Prospective subrogation has been held to follow the ambit of 502{e)(1)(B). It basically asks to have it determined that our subrogation rights are to be determined the same way as our contingent reimbursement rights, which isn't true.

THE COURT: Either way, they're just theoretical; aren't they? They're just static out there.

MR. BRUNSTAD: Here's the problem. This —

THE COURT: Ten years from now if they blow a worker's comp claim and you have to step up, you're subrogated, correct?

MR. BRUNSTAD: Not if their objection stood. What they were seeking — and this is what we were arguing about; this is why we had these long negotiations that resulted in the stipulation — we were arguing about whether we would have our subrogation rights. We said — [22] and they've acknowledged recently but they didn't then; they've acknowledged recently that well, subrogation rights aren't a claim. We really can't do anything to them. Beautiful. But the position they were taking then, which fomented the litigation and the back and forth and the negotiations, was that they were taking the position they could cut off our

subrogation rights. And by doing that, they would essentially convert Travelers' Surety Bond into an insurance policy.

THE COURT: How can — how can the Debtor have done that in the context of the claim objection? Wouldn't — if they wanted to have a declaration that you don't have any now or ever in the future, it would require an adversary proceeding for dec relief; wouldn't it? And isn't the context of this objection just to knock out some specific claim by number?

MR. BRUNSTAD: Well, Your Honor, we briefed that. That's exactly what we responded to. They can't do that. But they didn't agree; they wouldn't concede that point. They were pressing forward with the litigation. That's the problem. We had to defend our subrogation right. We also had to defend our reimbursement rights in a very narrow way. It is true that contingent reimbursement rights are subject to disallowance under 502(e)(1)(B), and the Court is fully aware why. You can't double dip; you can't have [23] both the worker's claim and the surety's claim at the same time.

However — however, 502(j) of the Bankruptcy Code allows you to be able in the future if the contingency matures to have your disallowed claim reconsidered.

THE COURT: Well, or alternatively, you're allowed to assert a new claim against this Debtor.

MR. BRUNSTAD: It depends on what the plan says. Some plans cut off —

THE COURT: Well, did this plan attempt to cut off that right?

MR. BRUNSTAD: It didn't say.

THE COURT: Well, that strikes me then that it didn't cut it off.

MR. BRUNSTAD: Correct, Your Honor.

THE COURT: It's more like a path through.

MR. BRUNSTAD: This is a minor — this is a minor point, Your Honor. All that we were asking to do on the reimbursement side was to simply say, in the future, we would have a 502(j) right, whatever that might happen to be.

Now, we resolved these disputes in our stipulation. Our stipulation says it preserves our 502(j) right on page 5 of our stipulation, which is at Exhibit I. So we were successful in reaching agreement on that. There [24] was a little bit of fight, but it was a little fight, and we were able to agree on that.

We were also able to resolve what our subrogation rights would be in the stipulation. There's paragraph 7 on page 5 which says, nothing in the stipulation prejudices our subrogation rights or the Debtor's rights to object to them. And then paragraph 8 goes on to say, to the extent we are subrogated, we will hold our claims just like the workers as an unsecured claim, and we're perfectly entitled to subrogate it to whatever priority they have, except to the extent Section

507(d) provides otherwise. We had to fight for that. But we settled it.

The problem, Your Honor, is that —

THE COURT: Did you really have to fight? Doesn't the law give you that?

MR. BRUNSTAD: That's what the law gives us, but the Debtor objected to everything; that's the problem, Your Honor. We had to fight over all of these things to get to the point of the stipulation. We had to litigate it. We had to litigate what our subrogation rights —

THE COURT: Well, okay. But is that true? What if you'd just said, well, okay, we won't require paragraph 8. Don't you get it anyway? Doesn't the law give you exactly what paragraph 8 gives you?

MR. BRUNSTAD: It depends on what the plan says.

[25] THE COURT: Well, but what did the plan say on that subject?

MR. BRUNSTAD: At that point, Your Honor —

THE COURT: Silent, huh?

MR. BRUNSTAD: The plan provided that our subrogation rights were unimpaired except to the extent the Debtor would object otherwise. The plan specifically left open in its terms the right of the Debtor to make whatever objection it wanted to.

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THE COURT: But — but it didn't give up meritorious objections; there was nothing in the stipulation that surrendered to either side issues beyond the four corners of the stipulation.

MR. BRUNSTAD: True, Your Honor, except that the plan was not a stand-alone item. It was coupled with their express objection which they filed to our claim, which they tried to eviscerate all of our rights. That is the problem. Standing on itself, the plan language would have been fine. The problem was that the Debtor commenced litigation against us by filing an objection to our claim in which they asserted we had no rights now or in the future.

THE COURT: Well, suppose — suppose the Debtor hadn't asserted that but had just taken a claim and said, [26] this is a 502(e) or whatever subsection it is, period, and you gave up?

MR. BRUNSTAD: We wouldn't be here today.

THE COURT: But would you be allowed to recover your attorney's fees for asserting a claim?

MR. BRUNSTAD: Well, that gets into the second issue.

THE COURT: I mean now we're under pure Federal law; aren't we? If you file a claim that is not meritorious, you can't claim attorney's fees under any theory for defending an unmeritorious claim. Can you?

MR. BRUNSTAD: Well, I think, Your Honor, that we were entitled to file a Proof of Claim, because remember, at the time at which one files a Proof of Claim, one doesn't know if one has to pay on the underlying bonds or not.

THE COURT: I know, but you did know on the day — Travelers knew on that day that — it didn't know that there was any claim.

MR. BRUNSTAD: Correct.

THE COURT: In other words, it was a protective filing —

MR. BRUNSTAD: Correct, Your Honor.

THE COURT: — which is much different from the kind of claim you would have filed it you'd already written [27] a check for two million dollars to some bunch of employees.

MR. BRUNSTAD: Correct, Your Honor.

THE COURT: So —

MR. BRUNSTAD: Correct, Your Honor. Our Proof of Claim was simply that, a very simple form in which we said we were — we just wanted everybody to know what our rights are. We attached — we attached a copy of our bonds; we attached a copy of the indemnity agreement.

THE COURT: No, I know. I know. I know what you did. But I mean what — what you're saying in a sense — let me see if I can restate it without — because I'm a fly on the

wall here and I'm just going to try to summarize — Travelers says, you know, we filed a claim that is — that really there was nothing to claim, and the Debtor could have objected to that claim all by itself, and we're — we don't get paid for it. But what the Debtor did is it asked for more in the objection than it took to knock the claim out.

MR. BRUNSTAD: Right.

* * *

[32] * * *

THE COURT: But I don't think it would help your [33] cause here. It's just to show that you did your homework. That's all. But come on, where's the entitlement for protecting your bankruptcy law rights? That's what I've got to —

BRUNSTAD: Yes, Your Honor.

THE COURT: — in the context of default.

MR. BRUNSTAD: Let's take the simple illustration of having to file a Proof of Claim in bankruptcy to protect one's rights. Is that something for which if you incur attorney's fees to file a Proof of Claim, you're entitled to get paid for it? I think the answer, Your Honor, is yes.

THE COURT: Well, we don't usually allow attorney's fees on preparation of Proofs of Claim in here generally. I mean —

MR. BRUNSTAD: If your —

THE COURT: — but you know, that begs the question, because you didn't have to file a Proof of Claim.

MR. BRUNSTAD: Well, Your Honor, it turns out — well —

THE COURT: You had no claim to file. I mean that's the point I was making. I'm not laughing at you or your client, but the fact that the objections were meritorious proves that you had no claim to file. Maybe the Debtor went a little bit too far in trying to seek more [34] than just get the claim knocked out, and I want to hear your comments on that.

MR. BRUNSTAD: That's the problem, Your Honor.

* * *

[35] THE COURT: Yes, but objections would have been sustained to all of them.

MR. BRUNSTAD: Except they've all been rendered unimpaired.

THE COURT: I know, but look, I'll grant you maybe — I mean I have to say, Mr. Brunstad, it's a little bit hard for me to think that a company that walks into the Bankruptcy Court with a four billion dollar net worth and from the first day of its now two and a quarter year-old bankruptcy is committed to pay its creditors in full, it's possible there might have been some worker out there who wasn't getting his

worker's comp coverage, but I don't really think it's really accurate to assume it. And maybe even by the claims bar date, you couldn't possibly have gotten every single fact, but the fact of the matter is, not one of those claimants nor one of the sureties has one dollar worth of claim in the case. Right?

MR. BRUNSTAD: Correct. That's correct. The only parties who actually hold claims are the workers. But the surety has rights in connection with those claims, and that is what we were trying to protect. That is why we filed our Proof of Claim, and those are the rights that we wanted everyone to be on notice of that we do have those interests and those rights. We were never seeking to get dollars out of the estate for amounts that we didn't pay.

* * *

[44] * * *

THE COURT: They didn't — they didn't ask for a declaration that you never ever under any subsequent events have no subrogation rights. I mean — I mean (d) can't be construed that way because it talks about getting your principals, your obligees paid in full. And (e) is repetitive of (d), and (f) is kind of nothing.

MR. BRUNSTAD: Well, the first thing they did was —

THE COURT: (g) is boilerplate, so —

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MR. BRUNSTAD: The first thing, Your Honor, they did was they asked to sustain the objections to the claims. Among their objections was their argument that:

> "Our subrogation rights are for prospective subrogation and they fall within the ambit of 502(e)(1)(B)."

That's what they briefed, and they asked to sustain their objections. For what other reasons could it be than what they briefed. They've submitted an order to Your — and they cite to the *Georgia Tubing* case; and they basically make an argument that there's no difference between contingent reimbursement claims and prospective subrogation rights. That's what they argued in their — that's what they argued and that's what they want Your Honor to do. If they didn't want Your Honor to do that, why did they argue [45] it? We had to respond to it. If we had gone by default and they got an order saying we have no prospective subrogation rights, or something broad saying all of the claims for relief in their objection are sustained, we'd be in the position of having to then come back at a future date and say, oh, no, no, no, it couldn't possibly have meant that. But as a lawyer, I couldn't counsel my client to take that kind of a risk, let a judgment enter against you where they're praying for relief to disallow your subrogation rights? And then hope that in the future, a court will go back and say well, that couldn't have been what the Court meant even though we didn't defend the claim?

THE COURT: Okay. So what you want me to do is to say that in the context of invoking some very specific bankruptcy provisions, namely 502 and its various subparts,

that the Debtor went one more step and turned this into a dec relief that challenged your subrogation rights as a matter of State law.

MR. BRUNSTAD: What the Debtor —

THE COURT: I mean that's what you're — that's what I think you're telling me you're concerned about.

MR. BRUNSTAD: My concern was this, Your Honor, because I've seen this in many, many, many bankruptcy cases; this is not the first. This is in a series of many [46] bankruptcy cases. The Debtor was trying to eliminate our subrogation rights. One of the things that we said — one of our counter arguments was that the Debtor couldn't do that, and we actually resolved it by entering into the stipulation.

The problem though, Your Honor, and the very narrow problem, is that we had to litigate over this issue. We had to respond to their objection in which they claimed that our subrogation rights were the same as contingent reimbursement claims and therefore should be disallowed. We had to brief it, and then we had to engage in settlement negotiations over it, and my client had to incur legal fees to do that. It was acting to protect its rights which under the very broad indemnification provision in the contract, which isn't as narrow by its language or its intent as opposing counsel suggests — he was again quoting selectively from it — we're entitled to — the client is entitled to recover its attorney's fees for having to defend its State law rights.

And this is not because we came in here and asked the Court for a declaration; it's because we negotiated language

for the plan which the Debtor then unilaterally changed and then commenced litigation against us. And as part of that litigation was very specifically briefing its theory that our rights were just contingent reimbursement [47] rights — claims, and should be disallowed on that basis. That's the problem. That's why we had to litigate. If the Debtor had honored its commitment and stuck with the negotiated language that we agreed to and was put in the plan, we wouldn't be here. We'd be done.

* * *

[49] * * *

MR. BRUNSTAD: And we did not — we never disputed that our contingent reimbursement rights were subject to disallowance.

THE COURT: Well, that's what I was leading up to. The surety would go out on the same argument.

MR. BRUNSTAD: Correct. Absolutely. We never — we never — we never opposed that. The only thing we wanted though was recognition, because this is a solvent debtor who is paying all claims in full. It's not a pot plan where once the money is gone; it's gone. This is a solvent debtor. We wanted to make sure that our 502(j) rights were preserved with respect to our contingent reimbursement claim.

But we never had any objection to having our contingent reimbursement claim disallowed. That was not an issue. We didn't litigate over that. We didn't press that. And we resolved

the 502 issue in our stipulation. But what we were fighting about and what we fought about and what we had to brief in response to the Debtor's objection was that a subrogation right is not the same [50] thing as a contingent reimbursement claim. I mean on page 5 of their objection, they argued:

> "To the extent Travelers asserts a right of subrogation, such claims are for prospective subrogation. Prospective subrogation has been held to fall within the ambit of 502(e)(1)(B). 502(e)(1)(B) deals with contingent reimbursement claims."

That is wrong. They put that issue — they put that issue in the litigation. We briefed — we had to incur legal fees to brief and respond to it. Even though they now concede, of course, that's not right, we still had to — they now concede that a subrogation right is not a claim, okay. They said so in their papers. Even though they now concede that, we had to fight about it then, and we had to fight about it because they chose to litigate that issue.

Now, we ultimately settled it in the stipulation. But the stipulation does several things. It preserves our 502(j) rights. It preserves our subrogation rights, subject to their right to object, and it allows us to file our claim for attorney's fees, which we've done. So now we are litigating over whether we're entitled to attorney's fees.

* * *

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[56] * * *

MR. BRUNSTAD: Well, that's I think a point, Your Honor. One point in response to that, Your Honor, is that no, there's no bankruptcy section that allows them to object to our subrogation rights. They were trying to do it under some other theory because bankruptcy law doesn't allow them to do it. Nothing in the Bankruptcy Code allows a debtor to object to a surety's subrogation rights, because they are rights that arise between the surety and the bond beneficiary. The debtor has nothing to do with it. We stand in the shoes of the workers. It's the same thing as though someone took assignment. The law says, subrogation operates — or basically is the same thing as assignment by operation of law.

THE COURT: Well then, if that's true, what you just said, then the Debtor wasn't — there was no threat to you when they were saying they want to reserve the right to object to your subrogation rights. Because you just essentially said that they couldn't.

MR. BRUNSTAD: That's right. We said they couldn't, but they were doing it any way. We still had to defend. And besides other courts have messed it up because [57] as Your Honor point out, only four people in the world know about this, and lot of other judges — I feel very fortunate to be in front of a judge who does understand this because I've spent hours in front of other courts trying to explain the difference between subrogation and reimbursement.

THE COURT: Well, I had the good fortune to do some representation of bonding companies in bankruptcy in my prior life, not as much as you do, but enough.

MR. BRUNSTAD: But Your Honor, the point is, is that —

THE COURT: And I know about the *Pearlman* case too.

MR. BRUNSTAD: Yes. Which is a fabulous case. But the point, Your Honor, is that even though nothing in the Bankruptcy Code said or even arguably says they can eliminate our subrogation rights, they tried to do it anyway. And so we had to litigate that point, and we incurred legal fees accordingly.

THE COURT: I understand your point.

* * *

[75] * * *

THE COURT: Okay. Listen. I appreciate all the work and all the sophisticated legal theories. I'm going to resist the temptation to take the matter under advisement. I'm going to sustain the Debtor's objections, Mr. Brunstad, and I'll explain myself.

First of all, what I'm going to overrule the Debtor, is on any adequacy of the Proof of Claim. Indeed, your Proof of Claim was filed, but without as much data and documentation as maybe it might have been, but we're dealing with experienced counsel who know how to exchange information and so, just as if I were going to have an evidentiary hearing, I might give the Debtor more time to [76] deal with the specifics that only came more recently, I'm not going to fault Travelers for having this Proof of Claim sort of gradually grow into the five-pound document it is.

So the Debtor's points on that theory are rejected. I'm satisfied, having listened to the arguments and looked at the documents and my familiarity with the cases — I won't lie to you; I didn't go back and read *Security Mortgage* this morning. But I'm going to tell you how I deal with the *Security Mortgage* argument.

First of all, I do think Mr. Kaplan is correct that the challenges to the Travelers claim were in fact all Bankruptcy Code challenges. If he had filed an adversary proceeding to declare some or all of the indemnity agreements or the bonds or whatever invalid, and had gone for declaratory relief and certainly had sought that kind of relief, I might not come out the same way. But the legal theory of the Debtor's challenge to the claims is pure bankruptcy.

Now, I understand your point, Mr. Brunstad, of a concern that may be lurking between the lines somewhere with something more than the objection to claim. I just simply don't buy it. I recognize that maybe you and your client had no choice but to try to protect your position. But I don't think — and again, I don't fault you for that or fault Travelers for that, but I don't think that you can [77] sort of say, you know, we thought there was a thief hiding under the bed so we had to clear out under the bed. I don't think there was a risk there. This was an objection to claims. It wasn't more than that, and I don't believe under the traditional default rules, you could have done any worse than have had the claims disallowed. And so therefore, to the extent that you want me to accept the argument that that objection was more than what I'm going to call a pure bankruptcy 502 type challenge, I simply don't agree. And if you disagree with me, as I have no doubt you do, you'll have to convince some other judge to agree with you on that point.

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As far as the protecting — Travelers protecting its position by negotiating with the plan and the disclosure statement, of course, you had every right to do that. We're back to the same thing I said before; I just don't think the Debtor has to pay for it, because I think it's bankruptcy law.

So then I come to *Security Mortgage*, and of course, I can joke that we in the Ninth Circuit are — have our own rules here, but we do honor Supreme Court cases. I think *Security Mortgage* is distinguishable, but even if it isn't, I'm bound to follow Nine Circuit precedent, and you're going to have to convince the Ninth Circuit that it was wrong in all those other cases. And *Fobian* and *Renfrow* [78] and others, some of which I did simply refer to in that *Hassen Imports* case, they have made it clear to me, although I see it more often than not in a credit card dischargeability case that where liability is not an issue but dischargeability is, the creditor doesn't get his attorney's fees. Where liability is challenged and dischargeability is, the court has to sort it through. And I see no difference in other aspects of bankruptcy application, and I am not prepared to say that one little piece of concern about what was sought in the objection to claim implicated your client's State law rights such that you can now invoke the attorney's fees provision.

So I don't think *Security Mortgage* has been ignored by the several Ninth Circuit cases, but even if it has, I'm bound to follow Ninth Circuit authority, and I'm going to follow it. And I think that Mr. Kaplan's arguments are well taken here. So I don't need to get to the question, and I won't address the question, of whether the fees were reasonable in whole or in part. I simple agree with Mr. Kaplan that as a matter of bankruptcy law, they cannot be assessed against the Debtor in

any amount. So I will sustain the objections for those reasons. I will ask Mr. Kaplan to submit — he's already got it in his hand — submit a form of order that simply recites that the objections are sustained for the reasons stated on the [79] record.

MR. KAPLAN: Your Honor, may we approach with the proposed order?

THE COURT: Show it to counsel.

But, Mr. Brunstad, I do appreciate the very, very thorough legal analysis of the issues, and the fact that I may come out disagreeing with you doesn't mean I don't very much respect your analysis of the theories — or Mr. Kaplan's. And this is a stimulating and challenging area in a frankly obscure area of the law, as you know.

MR. BRUNSTAD: Yes, it is, Your Honor. I very much appreciate Your Honor's understanding of the area of the law, however; it makes things much easier. One —

THE COURT: Do you have any problem with the form of order?

MR. BRUNSTAD: I do not, Your Honor.

THE COURT: All right.

* * * *

FILED
NOV 2 8 2006
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 05-1429

IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

SUPPLEMENTAL JOINT APPENDIX

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PETITION FOR CERTIORARI FILED MAY 8, 2006
CERTIORARI GRANTED OCTOBER 6, 2006

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B10 (Official Form 10)(4/01)

United States Bankruptcy Court	Northern District of California (San Francisco Division)	PROOF OF CLAIM
Name of Debtor Pacific Gas and Electric Company	Case Number 01-30923 DM	

NOTE: This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A request for payment of an administrative expense may be filed pursuant to 11 U.S.C. § 503.

Name of Creditor (The person or other entity to whom the debtor owes money or property): **Travelers Casualty and Surety Company of America and Travelers Casualty and Surety Company as Administrator for Reliance Insurance Company for itself, as successor in interest by merger with United Pacific Insurance Company, and for Related Reliance Insurance Companies**	☐ Check box if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy of statement giving particulars.
Name and address where notices should be sent: Susan M. Camilli Travelers Casualty and Surety Company One Constitution Plaza-HO2 Hartford, CT 06183-9062 (860) 277-4273 G. Eric Brunstad, Jr. Bingham Dana LLP One State Street Hartford, CT 06103 (860) 240 2700	☐ Check box if you have never received any notices from the bankruptcy court in this case. ☒ Check box if the address differs from the address on the envelope sent to you by the court. THIS SPACE IS FOR COURT USE ONLY
Account or other number by which creditor identifies debtor:	Check here if this claim ☐ replaces ☐ amends a previously filed claim, dated:

1. Basis for Claim
   - ☐ Goods sold
   - ☐ Services performed
   - ☐ Money loaned
   - ☐ Personal injury/wrongful death
   - ☐ Taxes
   - ☒ Other (See attached Addendum)
   - ☐ Retiree benefits as defined in 11 U.S.C. § 1114(a)
   - ☐ Wages, salaries, and compensation (fill out below)

   Your SS #_____
   Unpaid compensation for services performed from _____ (date) to _____ (date)

2. Date debt was incurred:

3. If court judgment, date obtained:

4. Total Amount of Claim at Time Case Filed: $(See attached Addendum)
   If all or part of your claim is secured or entitled to priority, also complete Item 5 or 6 below.
   ☐ Check this box if claim includes interest or other charges in addition to the principal amount of the claim. Attach itemized statement of all interest or additional charges.

5. Secured Claim
   ☐ Check this box if your claim is secured by collateral (including a right of setoff).
   Brief Description of Collateral:
   ☐ Real Estate ☐ Motor Vehicle ☐ Other
   Value of Collateral: $_____

   Amount of arrearage and other charges at time case filed included in secured claim, if any:

   ☒ Unsecured Non-priority Claim $(See Addendum)
   A claim is unsecured if there is no collateral or lien on property of the debtor securing the claim or to the extent that the value of such property is less than the amount of the claim.

6. Unsecured Priority Claim
   ☒ Check this box if you have an unsecured priority claim
   Amount entitled to priority $ (See attached Addendum)
   Specify the priority of the claim:
   - ☐ Wages, salaries, or commissions (up to $4,650),* earned within 90 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier - 11 U.S.C. § 507(a)(3).
   - ☐ Contributions to an employee benefit plan - 11 U.S.C. § 507(a)(4).
   - ☐ Up to $2,100* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use - 11 U.S.C. § 507(a)(6).
   - ☐ Alimony, maintenance, or support owed to a spouse, former spouse, or child - 11 U.S.C. § 507(a)(7).
   - ☒ Taxes or penalties owed to governmental units - 11 U.S.C. § 507(a)(8).
   - ☐ Other - Specify applicable paragraph of 11 U.S.C. § 507(a)(__).

   *Amounts are subject to adjustment on 4/1/04 and every 3 years thereafter with respect to cases commenced on or after the date of adjustment.

7. Credits: The amount of all payments on this claim has been credited and deducted for the purpose of making this proof of claim.

8. Supporting Documents: Attach copies of supporting documents, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, court judgments, mortgages, security agreements and evidence of perfection of lien. DO NOT SEND ORIGINAL DOCUMENTS. If the documents are not available, explain. If the documents are voluminous, attach a summary. (See attached Addendum)

9. Date-Stamped Copy: To receive an acknowledgment of the filing of your claim, enclose a self-addressed envelope and copy of this proof of claim.

THIS SPACE IS FOR COURT USE ONLY

Date	Sign and print the name and title, if any, of the creditor or other person authorized to file this claim (attach copy of power of attorney, if any):
September 4, 2001	**Travelers Casualty and Surety Company of America and Travelers Casualty and Surety Company as Administrator for Reliance Insurance Company for itself, as successor in interest by merger with United Pacific Insurance Company, and for Related Reliance Insurance Companies** By: Susan M. Camilli **Susan M. Camilli, Claim Counsel**

Penalty for presenting fraudulent claim: Fine of up to $500,000 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 3571.

CTDOCS:146207.2

SJA1

ADDENDUM TO PROOF OF CLAIM OF (A) TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA AND (B) TRAVELERS CASUALTY AND SURETY COMPANY AS ADMINISTRATOR FOR RELIANCE INSURANCE COMPANY (1) FOR ITSELF, (2) AS SUCCESSOR IN INTEREST BY MERGER WITH UNITED PACIFIC INSURANCE COMPANY, AND (3) FOR RELATED RELIANCE INSURANCE COMPANIES

1. Susan M. Camilli is Claim Counsel of the Bond Claim Department of Travelers Casualty and Surety Company has a business address of One Constitution Plaza - 14 CZ, Hartford, Connecticut 06183-9062 and is authorized to file this Proof of Claim on behalf of (a) Travelers Casualty and Surety Company of America ("Travelers of America"), and (b) Travelers Casualty and Surety Company as Administrator for Reliance Insurance Company (1) for itself, (2) as successor in interest by merger with United Pacific Insurance Company, and (3) for related Reliance Insurance companies (the "Reliance Entities")(together hereinafter, "Travelers").

2. All notices and other pleadings relating to this Proof of Claim should be addressed as follows:

SJA2

The Travelers Casualty and Surety Company
One Constitution Plaza - 14 CZ
Hartford, CT 06183-9062
Attn.: Susan M. Camilli, Esq.

and

G. Eric Brunstad, Jr., Esq.
Bingham Dana LLP
One State Street
Hartford, CT 06103

3. From time to time prior to the commencement of this case, the Reliance Entities issued certain surety bonds (collectively the "Bonds") to certain obligees with respect to certain obligations of the Debtor to such obligees including, without limitation, those bonds summarized on Exhibit A hereto, which indicate that the Debtor is or may be a principal thereunder. Exhibit A may contain Bonds as to which liability has been extinguished by the obligees, by the terms of the Bond, or by operation of law. Travelers reserves the right to amend Exhibit A to identify and include other Bonds. Attached as Exhibit B is the State of California Department of Industrial Relations Self Insurance bond # B168-61-91. A copy of all other Bonds is available upon request by the Debtor.

4. From time to time prior to the commencement of this case, Travelers of America issued certain surety bonds (collectively the "Bonds") to certain obligees with respect to certain obligations of the Debtor to such obligees including, without limitation, the bond included as Exhibit

C hereto, which indicates that the Debtor is a principal thereunder. Travelers reserves the right to amend Exhibit C to include other Bonds.

5. Travelers may hereafter be required to make payments under the Bonds. As a result of such payments, Travelers will become subrogated to the rights of the obligees against the Debtor with respect to such payments and Travelers has the right to be reimbursed and indemnified by the Debtor with respect to all such payments, whether such payments are made on behalf of the Debtor as a principal or on behalf of another principal under any Bond.

6. Alternatively, the Debtor has executed and delivered certain Continuing Agreements of Indemnity pursuant to which the Debtor is required to pay all premiums and indemnify Travelers, and hold Travelers harmless from and against every claim, demand, liability, cost, charge, suit, judgment and expense incurred by Travelers in connection with, among other things, (1) the furnishing of any Bond or (2) the enforcement of any Continuing Agreement of Indemnity. Additionally, the Debtor has executed and delivered a Specific Indemnity Agreement as relates to the State of California Department of Industrial Relations Self Insurance bond # B168-61-91. Copies of the Continuing Agreements of Indemnity and the Specific Indemnity Agreement are annexed hereto as Exhibit D. Travelers reserves the right to amend Exhibit D to include other indemnity agreements. Travelers asserts herein a claim with respect to the Debtor's obligations to Travelers under both the Continuing Agreements of Indemnity and the Specific Indemnity Agreement.

7. Alternatively, pursuant to Bankruptcy Code 501(b), Travelers submits claims for and on behalf of the obligees named in the Bonds listed in Exhibit A and included in Exhibit C and all other persons who may have claims against the Debtor based upon which Travelers may become obligated to make any payment and/or incur any expense under the Bonds. These claims are entitled to priority in part pursuant to Bankruptcy Code § 507(a)(8).

8. The amount of this claim is unliquidated and contingent as of this date.

9. Travelers reserves the right to assert an administrative claim under 11 U.S.C. § 503 for obligations arising out of the Debtor's postpetition activities and/or Bonds in effect postpetition. Travelers further reserves the right to amend this Proof of Claim as it becomes known, fixed and liquidated, and for other lawful purposes.

10. Travelers claims and asserts any rights of setoff or recoupment to which it may be entitled including without limitation setoff against any obligations which Travelers may have under insurance policies issued by it for or on behalf of the Debtor.

11. The filing of this proof of claim shall not constitute or be construed as an admission by Travelers of any liability or an election by Travelers of any remedy. Travelers reserves all rights and defenses.

12. This proof of claim is in addition to, and not in lieu of, any other proof of claim filed by any Travelers entity.

Mailing Address:
Self-Insurance Plans
3385 Watt Avenue, Suite I
Sacramento, California 95825

STATE OF CALIFORNIA
DEPARTMENT OF INDUSTRIAL RELATIONS
SELF-INSURANCE PLANS
SURETY BOND OF SELF INSURER OF WORKERS' COMPENSATION
(LABOR CODE SECTION 3701)

IN THE MATTER OF THE CERTIFICATE OF)
)
PACIFIC GAS AND ELECTRIC COMPANY)
P.O. Box 7779)
San Francisco, CA 94120-7779)
)
Employer, Certificate No. 0012)

SURETY BOND
NO. B1686191
INCREASE RIDER

WHEREAS, In accordance with Condition (3) of Surety Bond No. B1686191, naming Pacific Gas and Electric Company (a California corporation)

(hereinafter called Principal and Reliance Insurance Company as Surety; and

WHEREAS, The Director of Industrial Relations has called for an increase in the penal sum of said in the amount of at least Fifteen Million & no/100 Dollars ($15,000,000); and

NOW, THEREFORE, In accordance with the provisions of said bond, the penal sum thereof is hereby increased to One Hundred Million & no/100 Dollars ($100,000,000); and

IT IS UNDERSTOOD AND AGREED, That said increase shall be effective in accordance with the terms, provisions and limitations of said bond for all past, present, existing and potential liability of of the surety for said principal, as a self-insurer, without regard to specific injuries, date or dates of injuries, happenings or events; and

IT IS FURTHER UNDERSTOOD AND AGREED, That this rider shall be attached to and form a part of said bond.

Reliance Insurance Company
Name of Surety
580 California Street, Suite 1300
Address
San Francisco, CA 94104
City, State, Zip
(415) 273-5205
Telephone Number

THIS bond rider is executed under an unrevoked appointment or power of attorney.

I certify (or declare) under penalty of perjury under the laws of the State of California that I have executed the foregoing increase rider to the above-described surety bond under an unrevoked power of attorney.

Executed in San Francisco, CA on April 13, 2000
(City/State) (Date)

Signature of Attorney-in-Fact
Theresa Fernenich
Printed or Typed name of Attorney-in-Fact

A copy of the transcript or record of the unrevoked appointment, power of attorney, bylaws, or other instrument, duly certified by the proper authority and attested by the seal of the insurer verifying or authorizing the person who executed the bond to do so for and in behalf of the insurer, must be filed in the office of the clerk of the county of Sacramento or must be included with this bond for such filing.

STATE OF CALIFORNIA
DEPARTMENT OF INDUSTRIAL RELATIONS

Date

Manager, Self-Insurance Plans,
For the Director of Industrial Relations

Form A4-21b (4/92)
/bs

(Prepare in Triplicate)

SJA6

EXECUTED IN TRIPLICATE

Mailing Address:
Self-Insurance Plans
2265 Watt Avenue, Suite 9
Sacramento, California 95825

STATE OF CALIFORNIA
DEPARTMENT OF INDUSTRIAL RELATIONS
SELF-INSURANCE PLANS
SURETY BOND OF SELF INSURER OF WORKERS' COMPENSATION
(LABOR CODE SECTION 3701)

IN THE MATTER OF THE CERTIFICATE OF
PACIFIC GAS AND ELECTRIC COMPANY
P.O. Box 7779
San Francisco, CA 94120-7779

Employer Certificate No. 0012

SURETY BOND
NO. B1686191
PREMIUM: $62,978.00 - 1 YR.

KNOW ALL PERSONS BY THESE PRESENTS:
THAT Pacific Gas and Electric Company (a California corporation)
(Employer)
whose address for service is P.O. Box 7779, San Francisco, CA 94120-7779
as PRINCIPAL, and Reliance Insurance Company
(Surety)
whose address for service is 580 California Street Ste 1300 San Francisco, CA 94104
a corporation organized under the laws of _____ and authorized to transact a general surety business in the State of California, as Surety, are held and firmly bound to the State of California in the penal sum of Fifty Four Million Seven Hundred Sixty Three Thousand Two Hundred Two****** dollars ($54,763,202) for which payment we bind ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.

WHEREAS, In accordance with the provisions of Sections 3700 to 3705 of the Labor Code of California, the Principal elected to self-insure, and made application for, or received from the Director of Industrial Relations of the State of California, a Certificate of Consent to Self-Insure, upon a furnishing of proof satisfactory to the Director of Industrial Relations of ability to self-insure and to compensate any or all employees of said principal for injury or disability, and their dependents for death incurred or sustained by said employees, pursuant to the terms, provisions and limitations of said Labor Code.

NOW THEREFORE, the conditions of this bond or obligation are such that if Principal shall pay and furnish compensation, pursuant to the terms, provisions and limitations of said Labor Code to its employees for injury or disability, and to the dependents of its employees for death incurred or sustained by said employees, then this bond or obligation shall be null and void; otherwise to remain in full force and effect.

FURTHERMORE, It is understood and agreed that:

1. This bond may be amended, by agreement between the parties hereto and the Director of Industrial Relations, as to the identity of the principal herein named and, by agreement of the parties hereto, as to the premium or rate of premium. Such amendment must be by endorsement upon, or rider to, this bond, executed by the surety and delivered to or filed with the Director.

2. The surety does, by these presents, undertake and agree that the obligation of this bond shall cover and extend to all past, present, existing, and potential liability of said principal, as a self-insurer, to the extent of the penal sum herein named, without regard to specific injuries, date or dates of injuries, happenings or events.

3. The penal sum of this bond may be increased or decreased, by agreement between the parties hereto and the Director of Industrial Relations, without impairing the obligation incurred under this bond for the overall coverage of the said principal, for all past, present, and existing and potential liability, as a self-insurer, without regard to specific injuries, date or dates of injuries, happenings or events, to the extent, in the aggregate, of the penal sum as increased or decreased. Such amendment must be by endorsement.

4. This bond shall be continuous in form and shall remain in full force and effect unless terminated in the manner provided by law.

5. The aggregate liability of the Surety hereunder on all claims whatsoever shall not exceed the penal sum of this bond in any event.

(Continued on Reverse Side)

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6. Where the principal posts with the Director of Industrial Relations a replacement security deposit, in the form of a surety bond, irrevocable letter of credit, cash, securities or any combination thereof, in the full amount as may be required by the Director to secure all incurred liabilities for the payment of compensation of said principal under Labor Code Section 3701, the surety is released from the obligations under this surety bond upon the date of acceptance by the Director of said replacement security deposit.

7. In the event of a change in the proprietorship of the principal or the appointment of a receiver or trustee for said principal and thirty (30) days after the receipt of notice by the Director of Industrial Relations, State of California, given by registered or certified mail, by the principal or surety, herein named, the obligation of this bond shall terminate, save and except as to all past, present, existing and potential liability of the principal incurred as a self-insurer. This bond shall also terminate upon the revocation of the Certificate of Consent to Self-Insure, save and except as to all past, present, existing and potential liability of the principal, incurred as a self-insurer; and the principal and the surety, herein named, shall be notified in writing, by said Director, in the event of such revocation.

8. If the said principal shall suspend payment of workers' compensation benefits or shall become insolvent or a receiver shall be appointed for its business, the undersigned surety will become liable for the workers' compensation obligations of the principal on the date benefits are suspended and the surety shall begin payments within thirty (30) days after receipt of written notification by the Director of Industrial Relations of California to begin payments under the terms of this bond.

9. When the surety exercises its obligation to pay claims, it shall pay benefits due to the principal's injured workers without a formal award of the Workers' Compensation Appeals Board and such payment will be a credit against the penal sum of the bond. Administrative and legal costs incurred by the surety in discharging its obligations shall also be a charge against the penal sum of the bond, however, the total amount of this surety bond set aside for the payment of said administrative and legal expenses shall be limited to a maximum of ten percent (10%) of the total penal sum of the bond pursuant to Labor Code Section 3701(b). Payment by the surety of the principal's obligation for administrative and legal expenses under Section 3701(b) in an amount not to exceed 10% of the penal sum of the bond shall satisfy in full the surety's obligation to pay said administrative and legal expenses of the principal.

10. If any part or provision of this bond shall be declared unenforceable or held to be invalid by a court of proper jurisdiction, such determination shall not affect the validity or enforceability of the other provisions or parts of this bond.

11. If the Director of Industrial Relations of California directs the Self Insurer Security Fund to assume the payment of the workers' compensation obligations of the principal pursuant to Labor Code Section 3701.5, the surety shall pay upon written demand by the Director and within thirty (30) days of receipt of such demand to the Self Insurer Security Fund the entire penal sum of the bond that remains unpaid.

12. Disputes concerning the posting, renewal, termination, exoneration, or return of all or any portion of the principal's security deposit or any liability arising out of the posting or failure to post security, or the adequacy of the security or the reasonableness of administrative costs, including legal costs, arising between or among a surety, the issuer of an agreement of assumption and guarantee of workers' compensation liabilities, the issuer of a letter of credit, any custodian of the security deposit, the principal, or the Self Insurer Security Fund shall be resolved by the Director of Industrial Relations of California pursuant to Labor Code Section 3701.5(g).

13. This bond is executed by the Surety to comply with the provisions of Chapter 2, Title 14, Part 2 of the Code of Civil Procedure and the provisions of Article 1, Chapter 4, Part 1, Division 4 of the Labor Code and said bond shall be subject to all terms and provisions thereof.

Reliance Insurance Company
Name of Surety
580 California St., Ste. 1300
Address
San Francisco, CA 94104
City, State, Zip

THIS bond is executed under an unrevoked appointment or power of attorney.

I certify (or declare) under penalty of perjury under the laws of the State of California that I have executed the foregoing surety bond under an unrevoked power of attorney.

Executed in SAN FRANCISCO, CA. on APRIL 8, 1998
(City/State) (Date)

Signature of Attorney-In-Fact

Theresa Fermanich
Printed or Typed name of Attorney-In-Fact

A copy of the transcript or record of the unrevoked appointment, power of attorney, bylaws, or other instrument, duly certified by the proper authority and attested by the seal of the insurer vesting or authorizing the person who executed the bond to do so for and in behalf of the insurer, must be filed in the office of the clerk of the county of Sacramento or must be included with this bond for such filing.

AI (4-6-98)
Form No. A4-20(4/92)

SJA8

Reliance

RELIANCE INSURANCE COMPANY
Philadelphia, Pennsylvania

UNITED PACIFIC INSURANCE COMPANY
Federal Way, Washington

PLANET INSURANCE COMPANY
Home Office — Sun Prairie, Wisconsin
Administrative Offices — Philadelphia, Pennsylvania

CONTINUING AGREEMENT OF INDEMNITY
MISCELLANEOUS SURETY BONDS

THIS AGREEMENT is made by the undersigned for the continuing benefit of RELIANCE INSURANCE COMPANY, UNITED PACIFIC INSURANCE COMPANY and/or PLANET INSURANCE COMPANY (hereinafter referred to collectively as the "SURETY") for the purpose of saving each and all of them harmless and indemnifying each and all of them from all loss and expense in connection with any Bonds executed on behalf of any one or more of the following persons, firms or corporations:

Pacific Gas & Electric Company

(hereinafter referred to as Applicant)

WITNESSETH,

WHEREAS, the Applicant, individually, jointly with others or on behalf of any of its subsidiaries, affiliates or divisions or their subsidiaries, affiliates or divisions now in existence or hereafter formed or acquired, or on behalf of individuals, partnerships or corporations, may desire or be required from time to time to give certain bonds, undertakings, or instruments of guarantee (all of which will hereinafter be included within the term "BOND" or "BONDS"), and

WHEREAS, upon the express condition that this instrument be executed, the Surety has executed or procured the execution, of or may from time to time hereafter execute or procure the execution of such Bonds, and the Surety may continue the Bond or Bonds heretofore executed and may forebear cancellation of such Bonds;

NOW, THEREFORE, in consideration of the execution of any such Bond or Bonds or the forbearance of cancellation of existing Bonds and as an inducement to such execution or forbearance, we, the Undersigned, agree and bind ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, as follows:

FIRST: To pay to the Surety in advance upon the execution of each Bond the initial premium computed in accordance with the rates currently charged by the Surety at the time such Bond is executed and the Undersigned will also pay all renewal or additional premiums computed at such rates until proof is furnished satisfactory to the Surety of its discharge from all liability under such Bond.

SECOND: To indemnify, and keep indemnified, and hold and save harmless the Surety against all demands, claims, loss, costs, damages, expenses and attorneys' fees whatever, and any and all liability therefor, sustained or incurred by the Surety by reason of executing or procuring the execution of any said Bond or Bonds, or any other Bonds, which maybe already or hereafter executed for or at the request of the Undersigned, or renewal or continuation thereof; or sustained or incurred by reason of making any investigation on account thereof, prosecuting or defending any action brought in connection therewith, obtaining a release therefrom, recovering or attempting to recover any salvage in connection therewith or enforcing by litigation or otherwise any of the agreements herein contained. Payment of amounts due Surety hereunder together with legal interest shall be payable upon demand.

THIRD: That if Surety shall be required or shall deem it necessary to set up a reserve in any amount to cover any claim, demand, liability, expense, suit, order, judgment or adjudication under or on any Bond or Bonds or for any other reason whatsoever, to immediately upon demand deposit with Surety an amount of money sufficient to cover such reserve and any increase thereof, at anytime, in payment or compromise of any liability, claims, demands, judgment, damages, fees and disbursements or other expenses; and the Undersigned, in the event of their failure to comply with such demand, hereby authorize and empower any attorney of any court of record of the United States or any of its territories or possessions, to appear for them or any of them in any suit by Surety and to confess judgment against them or any of them for any sum or sums of money up to the amount of any or all Bond or Bonds, with costs, interest and reasonably attorneys' fees; such judgment, however, to be satisfied upon the payment of any and all such sums as may be found due by the Undersigned to Surety under the terms of this agreement. The authority to confess judgment as set forth herein shall not be exhausted by any one exercise thereof, but may be exercised from time to time and more than one time until all liability of the Undersigned to Surety shall have been paid in full. Demand shall be sufficient if sent by registered or certified mail to the Undersigned at the address or addresses given herein or last known to Surety, whether or not actually received.

FOURTH: All collateral security held by or assigned to the Surety may be used by the Surety at any time in payment of any claim, loss or expense which the Undersigned have agreed to pay hereby, whether or not such claim, loss or expense arises out of or in connection with such Bond under which such collateral is held. The Surety may sell or realize upon any or all such collateral security, at public or private sale, with or without notice to the Undersigned or any of them, and with the right to be purchaser itself at any public sale, and shall be accountable to the Undersigned only for such surplus or remainder of such collateral security or the proceeds thereof as may be in the Surety's possession after it has been fully indemnified as in this agreement provided. The Surety shall not be liable for decrease in value or loss or destruction of or damage to such security, however caused.

FIFTH: The Surety shall have the right, at its option and in its sole discretion;

(a) To deem this Agreement breached should the Applicant become involved in any agreement or proceeding of liquidation, receivership, or bankruptcy, voluntarily or involuntarily, or should the Applicant, if an individual, die, be convicted of a felony, become a fugitive from justice, or for any reason disappear and cannot immediately be found by the Surety by use of usual methods.

(b) To adjust, settle or compromise any claim, demand, suit or judgment upon said Bond or Bonds, or any of them, unless the Undersigned shall request in writing the Surety to litigate such claim or demand, or defend such suit, or appeal from such judgment, and shall deposit with the Surety, at the time of such request, cash or collateral satisfactory to the Surety in kind and amount to be used in paying any judgment or judgments rendered with interest, costs and attorneys' fees.

All damage, loss or expense of any nature which the Surety may incur under Section FIFTH shall be borne by the Undersigned.

BD-1448 Ed. 5/84

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SIXTH: Each of the Undersigned expressly consent that, in the event of any action against the Surety arising out of its execution of such Bond or Bonds which is not handled pursuant to the provisions of Section FIFTH subparagraph (b), the Surety shall have the right to apply to the Court in which such action is brought for an order making them or any one or more of them defendants and hereby further consent to the granting of such application for making such order and agree to become parties defendant.

SEVENTH: The Surety shall have the exclusive right for itself and for the Undersigned to decide and determine whether any claim, demand, suit or judgment upon said Bond or Bonds shall, on the basis of liability, expediency or otherwise, be paid, settled, defended or appealed, and its determination shall be final, conclusive and binding upon the Undersigned (except as provided in Section FIFTH (b) hereof); and any loss, costs, charges, expense or liability thereby sustained or incurred, as well as any and all disbursements on account of costs, expenses, and attorneys' fees, deemed necessary or advisable by the Surety, shall be borne and paid immediately by the Undersigned, together with legal interest. In the event of any payment, settlement, compromise or investigation, an itemized statement of the payment, loss, costs, damages, expenses or attorneys' fees, sworn to by any officer of the Surety or the voucher or vouchers or other evidence of such payment, settlement or compromise shall be prima facie evidence of the fact and extent of the liability of the Undersigned to the Surety in any claim or suit hereunder and in any and all matters arising between the Undersigned and the Surety.

* Refer to Amended Paragraph Eighth Below *

[redacted]

NINTH: Each of the Undersigned does hereby waive all right to claim any property, including homestead as exempt from levy, execution, sale or other legal process under the law of any state, province or other government as against the rights of the Surety to proceed against the same for indemnity hereunder. The Undersigned hereby waive all notice of any default or any other act or acts giving rise to any claim under any said Bond or Bonds, and waive notice of any and all liability of the Surety under any said Bond or Bonds or any and all liability on the part of the Undersigned to the effect and end that each of the Undersigned shall be and continue liable to the Surety hereunder notwithstanding any notice of any kind to which the Undersigned might have been or be entitled and notwithstanding any defenses which the Undersigned might have been or be entitled to make.

TENTH: The Surety shall have every right and remedy which a personal surety without compensation would have, including the right to secure its discharge from the suretyship, and nothing herein contained shall be considered or construed to waive, abridge or diminish any right or remedy which the Surety might have if this instrument were not executed. The Undersigned will, on request of the Surety procure the discharge of the Surety from any Bond/s, and all liability by reason thereof. Separate suits may be brought hereunder as causes of action may accrue, and the pendency or termination of any such suit shall not bar any subsequent action. The Surety shall be notified immediately by the Undersigned of any claim or action which may result in a claim against the Surety, such notice to be given by registered mail to the Surety at its Home Office. In the event of legal proceedings against the Surety, upon or on account of any said Bond or Bonds, the Surety may apply for a court order making any or all of the Undersigned parties defendants, and such Undersigned hereby consents to the granting of such application and agrees to become such a party defendant and to allow judgment, in the event of judgment against the Surety, to be rendered also against such Undersigned in like amount and in favor of the Surety, if the Surety so desires.

ELEVENTH: The Surety may decline to execute any Bond herein applied for and it shall not be liable to the Undersigned and the Undersigned shall make no claim for any damages alleged to arise from such declination nor shall it be liable to the Undersigned should its Bond or Bonds be not accepted. Furthermore, the Surety shall have the absolute right to cancel any Bond in accord with any cancellation provision contained therein, to procure its release from any Bond under any law for the release of sureties; and the Surety is hereby released from any liability for expense, cost of damage alleged to be sustained by the Undersigned by reason of such cancellation or release of bond obligation.

TWELFTH: This Agreement shall, in all its terms and agreements, be for the benefit of and protect any person or company joining with the Surety in executing said Bond or Bonds, or any of them, or executing at the request of the Surety said Bond or Bonds, or any of them as well as any company or companies assuming co-suretyship or reinsurance therein.

THIRTEENTH: The Undersigned warrant that each of them is specifically and beneficially interested in the obtaining of each Bond. Failure to execute, or defective execution, by any party, shall not affect the validity of this obligation as to any other party executing the same and each such other party shall remain fully bound and liable hereunder. Invalidity of any portion or provision of this Agreement by reason of the laws of any state or for any other reason shall not render the other provisions or portion hereof invalid. Execution of any application for any Bond by the Applicant, or of any other indemnity agreement by any Undersigned for the Applicant shall in no way abrogate, waive or diminish any rights of Surety under this Agreement. The undersigned acknowledge that the execution of this Agreement and the undertaking of indemnity was not made in reliance upon any representation concerning the financial responsibility of any Undersigned, or concerning the competence of the Applicant to perform.

FOURTEENTH: Each of the Undersigned expressly recognizes and covenants that this Agreement is a continuing obligation applying to and indemnifying the Surety as to any and all Bonds (whether or not covered by any application signed by Applicant—such application to be considered between the parties hereto as merely supplemental to this continuing Agreement of indemnity) heretofore or hereafter executed by Surety on behalf of Applicant (whether acting alone or as a Co-adventurer) until this Agreement shall be canceled in the manner hereinafter provided. Any of the Undersigned may notify the Surety at its Home Office, of such Undersigned's withdrawal from this Agreement; such notice shall be sent by certified or registered mail and shall state when, not less than thirty days after receipt of such notice by the Surety, such withdrawal shall be effective. Such Undersigned will not be liable under this Agreement as to any Bonds executed by the Surety after the effective date of such notice; provided, that as to any and all such Bonds executed or authorized by the Surety prior to effective date of such notice and as to all and all renewals, continuations and extensions thereof or substitutions therefor regardless of when the same are executed, such Undersigned shall be and remain fully liable hereunder, as if said notice had not been served. Such withdrawal by any Undersigned shall in no way affect the obligation of any other Undersigned who has given no such notice of termination.

FIFTEENTH: The Surety shall have the right, and is hereby authorized and empowered but not required: (a) To increase or decrease the penalty or penalties of any such Bond or Bonds, to change the obligee or obligees therein, to execute any continuations, enlargements, modifications and renewals thereof or substitute therefore with the same or different conditions, provisions and obligees, and with the same or larger or smaller penalties, it being agreed that this instrument shall apply to and cover such new or changed bonds or renewals even though the consent of the Surety may or does substantially increase the liability of the Applicant and the Undersigned; (b) to take such steps as it may deem necessary or proper to obtain release from liability under any such Bond or Bonds.

SIXTEENTH: The foregoing indemnity shall apply as to all Bonds as aforesaid unless the Undersigned herein shall specifically designate in this paragraph the Bond to which his indemnity shall be limited and affix his signature following that designation.

BOND DESCRIPTION: _____

_____

_____

SIGNATURE: _____

SEVENTEENTH: The Surety shall be entitled to enforce the obligations hereof directly against any and all Undersigned without the necessity of first proceeding against the Applicant.

EIGHTEENTH: This Agreement shall constitute a Security Agreement to Surety and also a Financing Statement, both in accordance with the provisions of the Uniform Commercial Code of every jurisdiction wherein such Code is in effect, but the filing or recording of this Agreement shall be solely at the option of Surety and the failure to do so shall not release or impair any of the obligations of the Applicant or the Undersigned under this Agreement or otherwise arising, nor shall such failure be in any manner in derogation of the rights of Surety under this Agreement or otherwise.

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SEVERALTY: The rights and indemnifications of each Surety signatory to this Agreement shall be several and not joint with those of the other signatory Sureties as to any Bond issued by it to any Applicant and shall be enforceable against the Undersigned as to any and all Bonds issued to any Applicant hereunder.

RECITALS: All of the Undersigned hereby warrant and represent that this Agreement is executed pursuant to that certain State of California Public Utilities Commission Order dated December 18, 1991, which was conditioned upon that certain Application of Pacific Gas & Electric Co., before the Public Utilities Commission of the State of California to provide up to $500 million in capital support to regulated and unregulated subsidiaries or affiliates and which was dated May 2, 1991.

TERMS: Until the Surety shall have been furnished with competent legal evidence of its discharge without loss from any and all Bonds, the Surety shall have the right, upon twenty-four hours notice and during regular business hours, to free access to the books, records and accounts of each of the Undersigned for the purpose of examining the same for the sole purpose of evaluating its actual or threatened liability in connection with any bond. The Surety may furnish copies of any and all statements, agreements and financial statements and any information which it now has or may hereafter obtain concerning each of the Undersigned, to other persons or companies for the purpose of procuring co-suretyship or reinsurance or of advising interested persons or companies.

Signed, sealed, and dated this 11th day of June 1992.

_____ (Seal)	Pacific Gas & Electric Company (Seal)
Attest: _____ (Seal)	By: _____ (Seal)
BRIAN L. McGRATH	
_____ (Seal)	_____ (Seal)
_____ (Seal)	_____ (Seal)
_____ (Seal)	_____ (Seal)
_____ (Seal)	_____ (Seal)
_____ (Seal)	_____ (Seal)
_____ (Seal)	_____ (Seal)
_____ (Seal)	_____ (Seal)

_____
Name of Surety (Seal)

By: _____

IMPORTANT: Print or type the name and address of each signatory to this agreement. Each signature must be acknowledged. See REVERSE HEREOF.

INDIVIDUAL ACKNOWLEDGEMENT

STATE OF _____ ss.
COUNTY OF _____
On this _____ day of _____ 19___ before me personally appeared _____

to me known and known to me to be the individual(s) described in and who executed the foregoing agreement and acknowledged that _____ he _____ executed the same for the purposes, considerations and uses therein set forth. Given under _____ hand and official seal this _____ day of _____ 19___.

_____
Notary Public, residing at _____
(Commission expires _____)

CORPORATE ACKNOWLEDGEMENT

STATE OF CALIFORNIA ss.
COUNTY OF SAN FRANCISCO
On this 11th day of June 1992 before me personally came
RICHARD A. CLARKE

to me known, who being by me duly sworn, did depose and say: that he resides in San Rafael, Marin County, California
that he is the Chairman & Chief Executive Officer of the PACIFIC GAS AND ELECTRIC COMPANY
the corporation described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of the said corporation, and that he signed his name to the said instrument by like order.

MILDRED J. WILLIAMS
NOTARY PUBLIC - CALIFORNIA
CITY & COUNTY OF SAN FRANCISCO
My Commission Expires Aug. 7, 1993

Mildred J. Williams
Notary Public, residing at San Francisco, California
(Commission expires August 7, 1993)

CORPORATE ACKNOWLEDGEMENT

STATE OF CALIFORNIA ss.
COUNTY OF SAN FRANCISCO
On this 11th day of June 1992 before me personally came
BRIAN L. McGRATH

to me known, who being by me duly sworn, did depose and say: that he resides in Hillbrae, San Mateo County, California
that he is the Assistant Secretary of the PACIFIC GAS AND ELECTRIC COMPANY
the corporation described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of the said corporation, and that he signed his name to the said instrument by like order.

MILDRED J. WILLIAMS
NOTARY PUBLIC - CALIFORNIA
CITY & COUNTY OF SAN FRANCISCO
My Commission Expires Aug. 7, 1993

Mildred J. Williams
Notary Public, residing at San Francisco, California
(Commission expires August 7, 1993)

CORPORATE ACKNOWLEDGEMENT

STATE OF _____ ss.
COUNTY OF _____
On this _____ day of _____ 19___ before me personally came _____

to me known, who being by me duly sworn, did depose and say: that he resides in _____
that he is the _____ of the _____
the corporation described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of the said corporation, and that he signed his name to the said instrument by like order.

_____
Notary Public, residing at _____
(Commission expires _____)

IMPORTANT: Attach certified copy of Resolution authorizing execution of this instrument by Corporation.

SFO

Reliance

RELIANCE INSURANCE COMPANY
Philadelphia, Pennsylvania

UNITED PACIFIC INSURANCE COMPANY
Federal Way, Washington

PLANET INSURANCE COMPANY
Home Office—Sun Prairie, Wisconsin
Administrative Offices—Philadelphia, Pennsylvania

CONTINUING AGREEMENT OF INDEMNITY
MISCELLANEOUS SURETY BONDS

THIS AGREEMENT is made by the undersigned for the continuing benefit of RELIANCE INSURANCE COMPANY, UNITED PACIFIC INSURANCE COMPANY and/or PLANET INSURANCE COMPANY (hereinafter referred to collectively as the "SURETY") for the purpose of saving each and all of them harmless and indemnifying each and all of them from all loss and expense in connection with any Bonds executed on behalf of any one or more of the following persons, firms or corporations:

Pacific Gas & Electric Company

(hereinafter referred to as Applicant).

WITNESSETH,

WHEREAS, the Applicant; individually, jointly with others or on behalf of any of its subsidiaries, affiliates or divisions or their subsidiaries, affiliates or divisions now in existence or hereafter formed or acquired; or on behalf of individuals, partnerships or corporations, may desire or be required from time to time to give certain bonds, undertakings, or instruments of guarantee (all of which will hereinafter be included within the term "BOND" or "BONDS"), and

WHEREAS, upon the express condition that this instrument be executed, the Surety has executed or procured the execution, of or may from time to time hereafter execute or procure the execution of such Bonds, and the Surety may continue the Bond or Bonds heretofore executed and may forebear cancellation of such Bonds;

NOW, THEREFORE, in consideration of the execution of any such Bond or Bonds or the forbearance of cancellation of existing Bonds and as an inducement to such execution or forbearance, we, the Undersigned, agree and bind ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, as follows:

FIRST: To pay to the Surety in advance upon the execution of each Bond the initial premium computed in accordance with the rates currently charged by the Surety at the time such Bond is executed and the Undersigned will also pay all renewal or additional premiums computed at such rates until proof is furnished satisfactory to the Surety of its discharge from all liability under such Bond.

SECOND: To indemnify, and keep indemnified, and hold and save harmless the Surety against all demands, claims, loss, costs, damages, expenses and attorneys' fees whatever and any and all liability therefor, sustained or incurred by the Surety by reason of executing or procuring the execution of any said Bond or Bonds, or any other Bonds, which maybe already or hereafter executed for or at the request of the Undersigned, or renewal or continuation thereof; or sustained or incurred by reason of making any investigation on account thereof, prosecuting or defending any action brought in connection therewith, obtaining a release therefrom, recovering or attempting to recover any salvage in connection therewith or enforcing by litigation or otherwise any of the agreements herein contained. Payment of amounts due Surety hereunder together with legal interest shall be payable upon demand.

THIRD: That if Surety shall be required or shall deem it necessary to set up a reserve in any amount to cover any claim, demand, liability, expense, suit, order, judgment or adjudication under or on any Bond or Bonds or for any other reason whatsoever, to immediately upon demand deposit with Surety an amount of money sufficient to cover such reserve and any increase thereof, at anytime, in payment or compromise of any liability, claims, demands, judgment, damages, fees and disbursements or other expenses; and the Undersigned, in the event of their failure to comply with such demand, hereby authorize and empower any attorney of any court of record of the United States or any of its territories or possessions, to appear for them or any of them in any suit by Surety and to confess judgment against them or any of them for any sum or sums of money up to the amount of any or all Bond or Bonds, with costs, interest and reasonably attorneys' fees; such judgment, however, to be satisfied upon the payment of any and all such sums as may be found due by the Undersigned to Surety under the terms of this agreement. The authority to confess judgment as set forth herein shall not be exhausted by any one exercise thereof, but may be exercised from time to time and more than one time until all liability of the Undersigned to Surety shall have been paid in full. Demand shall be sufficient if sent by registered or certified mail to the Undersigned at the address or addresses given herein or last known to Surety, whether or not actually received.

FOURTH: All collateral security held by or assigned to the Surety may be used by the Surety at any time in payment of any claim, loss or expense which the Undersigned have agreed to pay hereby, whether or not such claim, loss or expense arises out of or in connection with such Bond under which such collateral is held. The Surety may sell or realize upon any or all such collateral security, at public or private sale, with or without notice to the Undersigned or any of them, and with the right to be purchaser itself at any public sale, and shall be accountable to the Undersigned only for such surplus or remainder of such collateral security or the proceeds thereof as may be in the Surety's possession after it has been fully indemnified as in this agreement provided. The Surety shall not be liable for decrease in value or loss or destruction of or damage to such security, however caused.

FIFTH: The Surety shall have the right, at its option and in its sole discretion;

(a) To deem this Agreement breached should the Applicant become involved in any agreement or proceeding of liquidation, receivership, or bankruptcy, voluntarily or involuntarily, or should the Applicant, if an individual, die, be convicted of a felony, become a fugitive from justice, or for any reason disappear and cannot immediately be found by the Surety by use of usual methods.

(b) To adjust, settle or compromise any claim, demand, suit or judgment upon said Bond or Bonds, or any of them, unless the Undersigned shall request in writing the Surety to litigate such claim or demand, or defend such suit, or appeal from such judgment, and shall deposit with the Surety, at the time of such request, cash or collateral satisfactory to the Surety in kind and amount to be used in paying any judgment or judgments rendered with interest, costs and attorneys' fees.

All damage, loss or expense of any nature which the Surety may incur under Section FIFTH shall be borne by the Undersigned.

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SIXTH: Each of the Undersigned expressly consent that in the event of any action against the Surety arising out of its execution of such Bond or Bonds which is not handled pursuant to the provisions of Section FIFTH subparagraph (b), the Surety shall have the right to apply to the Court in which such action is brought for an order making them or any one or more of them defendants and hereby further consent to the granting of such application for making such order and agree to become parties defendant.

SEVENTH: The Surety shall have the exclusive right for itself and for the Undersigned to decide and determine whether any claim, demand, suit or judgment upon said Bond or Bonds shall, on the basis of liability, expediency or otherwise, be paid, settled, defended or appealed, and its determination shall be final, conclusive and binding upon the Undersigned (except as provided in Section FIFTH (b) hereof); and any loss, costs, charges, expense or liability thereby sustained or incurred, as well as any and all disbursements on account of costs, expenses, and attorneys' fees, deemed necessary or advisable by the Surety, shall be borne and paid immediately by the Undersigned, together with legal interest. In the event of any payment, settlement, compromise or investigation, an itemized statement of the payment, loss, costs, damages, expenses or attorneys' fees, sworn to by any officer of the Surety or the voucher or vouchers or other evidence of such payment, settlement or compromise shall be prima facie evidence of the fact and extent of the liability of the Undersigned to the Surety in any claim or suit hereunder and in any and all matters arising between the Undersigned and the Surety.

* Refer to Amended Paragraph Eighth Below

~~EIGHTH: Until the Surety shall have been furnished with complete legal evidence of its discharge without loss from any and all Bonds, the Surety shall have the right at all times to free access to the books, records and accounts of each of the Undersigned for the purpose of examining the same. Each of the Undersigned hereby authorizes and requests any and all depositories in which funds of any of the Undersigned may be deposited to furnish to the Surety the amount of such deposits as of any date requested and any person, firm or corporation doing business with the Undersigned is hereby authorized to furnish any information requested by the Surety concerning any transaction. The Surety may furnish copies of any and all statements, agreements and financial statements and any information which is now has or may hereafter obtain concerning each of the Undersigned, to other persons or companies for the purpose of procuring co-suretyship or reinsurance or of advising interested persons or companies.~~

NINTH: Each of the Undersigned does hereby waive all right to claim any property, including homestead as exempt from levy, execution, sale or other legal process under the law of any state, province or other government as against the rights of the Surety to proceed against the same for indemnity hereunder. The Undersigned hereby waive all notice of any default or any other act or acts giving rise to any claim under any said Bond or Bonds, and waive notice of any and all liability of the Surety under any said Bond or Bonds or any and all liability on the part of the Undersigned to the effect and end that each of the Undersigned shall be and continue liable to the Surety hereunder notwithstanding any notice of any kind to which the Undersigned might have been or be entitled and notwithstanding any defenses which the Undersigned might have been or be entitled to make.

TENTH: The Surety shall have every right and remedy which a personal surety without compensation would have, including the right to secure its discharge from the suretyship, and nothing herein contained shall be considered or construed to waive, abridge or diminish any right or remedy which the Surety might have if this instrument were not executed. The Undersigned will, on request of the Surety procure the discharge of the Surety from any Bonds, and all liability by reason thereof. Separate suits may be brought hereunder as causes of action may accrue, and the pendency or termination of any such suit shall not bar any subsequent action. The Surety shall be notified immediately by the Undersigned of any claim or action which may result in a claim against the Surety, such notice to be given by registered mail to the Surety at its Home Office. In the event of legal proceedings against the Surety, upon or on account of any said Bond or Bonds, the Surety may apply for a court order making any or all of the Undersigned parties defendants, and such Undersigned hereby consents to the granting of such application and agrees to become such a party defendant and to allow judgment, in the event of judgment against the Surety, to be rendered also against such Undersigned in like amount and in favor of the Surety, if the Surety so desires.

ELEVENTH: The Surety may decline to execute any Bond herein applied for and it shall not be liable to the Undersigned and the Undersigned shall make no claim for any damages alleged to arise from such declination nor shall it be liable to the Undersigned should its Bond or Bonds be not accepted. Furthermore, the Surety shall have the absolute right to cancel any Bond in accord with any cancellation provision contained therein, to procure its release from any Bond under any law for the release of sureties; and the Surety is hereby released from any liability for expense, cost of damage alleged to be sustained by the Undersigned by reason of such cancellation or release of bond obligation.

TWELFTH: This Agreement shall, in all its terms and agreements, be for the benefit of and protect any person or company joining with the Surety in executing said Bond or Bonds, or any of them, or executing at the request of the Surety said Bond or Bonds, or any of them as well as any company or companies assuming co-suretyship or reinsurance thereon.

THIRTEENTH: The Undersigned warrant that each of them is specifically and beneficially interested in the obtaining of each Bond. Failure to execute, or defective execution, by any party, shall not affect the validity of this obligation as to any other party executing the same and each such other party shall remain fully bound and liable hereunder. Invalidity of any portion or provision of this Agreement by reason of the laws of any state or for any other reason shall not render the other provisions or portion hereof invalid. Execution of any application for any Bond by the Applicant, or of any other indemnity agreement by any Undersigned for the Applicant shall in no way abrogate, waive or diminish any rights of Surety under this Agreement. The undersigned acknowledge that the execution of this Agreement and the undertaking of indemnity was not made in reliance upon any representation concerning the financial responsibility of any Undersigned, or concerning the competence of the Applicant to perform.

FOURTEENTH: Each of the Undersigned expressly recognizes and covenants that this Agreement is a continuing obligation applying to and indemnifying the Surety as to any and all Bonds (whether or not covered by any application signed by Applicant—such application to be considered between the parties hereto as merely supplemental to this continuing Agreement of Indemnity) heretofore or hereafter executed by Surety on behalf of Applicant (whether acting alone or as a Co-adventurer) until this Agreement shall be canceled in the manner hereinafter provided. Any of the Undersigned may notify the Surety at its Home Office, of such Undersigned's withdrawal from this Agreement; such notice shall be sent by certified or registered mail and shall state when, not less than thirty days after receipt of such notice by the Surety, such withdrawal shall be effective. Such Undersigned will not be liable under this Agreement as to any Bonds executed by the Surety after the effective date of such notice; provided, that as to any and all such Bonds executed or authorized by the Surety prior to effective date of such notice and as to all and all renewals, continuations and extensions thereof or substitutions therefor regardless of when the same are executed, such Undersigned shall be and remain fully liable hereunder, as if said notice had not been served. Such withdrawal by any Undersigned shall in no way affect the obligation of any other Undersigned who has given no such notice of termination.

FIFTEENTH: The Surety shall have the right, and is hereby authorized and empowered but not required: (a) To increase or decrease the penalty or penalties of any such Bond or Bonds, to change the obligee or obligees therein, to execute any continuations, enlargements, modifications and renewals thereof or substitute therefore with the same or different conditions, provisions and obligees, and with the same or larger or smaller penalties, it being agreed that this instrument shall apply to and cover such new or changed bonds or renewals even though the consent of the Surety may or does substantially increase the liability of the Applicant and the Undersigned; (b) to take such steps as it may deem necessary or proper to obtain release from liability under any such Bond or Bonds.

SIXTEENTH: The foregoing indemnity shall apply as to all Bonds as aforesaid unless the Undersigned herein shall specifically designate in this paragraph the Bond to which his indemnity shall be limited and affix his signature following that designation.

BOND DESCRIPTION: _____

_____

SIGNATURE: _____

SEVENTEENTH: The Surety shall be entitled to enforce the obligations hereof directly against any and all Undersigned without the necessity of first proceeding against the Applicant.

EIGHTEENTH: This Agreement shall constitute a Security Agreement to Surety and also a Financing Statement, both in accordance with the provisions of the Uniform Commercial Code of every jurisdiction wherein such Code is in effect, but the filing or recording of this Agreement shall be solely at the option of Surety and the failure to do so shall not release or impair any of the obligations of the Applicant or the Undersigned under this Agreement or otherwise arising, nor shall such failure be in any manner in derogation of the rights of Surety under this Agreement or otherwise.

NINETEENTH: The rights of indemnification of each Surety signatory to this Agreement shall be individual and not joint with those of the other signatory Sureties as respects any Bond issued by it to any Applicant and shall be enforceable against the Undersigned as to any and all bonds issued to any Applicant hereunder.

ENTIETH: Notwithstanding any other provision of this agreement, the obligation of Pacific Gas d Electric Company ("PG&E") hereunder shall be limited to a term of one year from the date set rth below. In the event that PG&E obtains, on or before the expiration of such term, an thorization from the California Public Utilities Commission to undertake obligations similar those contained herein for a term of greater than one year, PG&E shall execute an extension this agreement in accordance with such authorization.

rther, notwithstanding any other provision of this agreement, if, for any reason, Pacific Gas d Electric Company fails to execute said extension of this agreement or a replacement reement on the same terms of this agreement by May 7, 1992, then Pacific Gas and ectric Company shall deposit funds with the Surety, five days following receipt of the rety's written demand therefore, which will be in an amount equal to one hundred twenty-five rcent (125%) of the Surety's outstanding bond liability at the time of the demand hereunder. e surety shall hold such collateral in accordance with the terms of Paragraph Four of this reement.

GHTH: Until the Surety shall have been furnished with competent legal evidence of its scharge without loss from any and all Bonds, the Surety shall have the right, upon 24 hours' tice and during regular business hours, to free access to the books, records and accounts of ch of the Undersigned for the purpose of examining the same for the sole purpose of evaluating s actual or threatened liability in connection with any bond. The Surety may furnish copies any and all statements, agreements and financial statements and any information which is now s or may hereafter obtain concerning each of the Undersigned, to other persons or companies r the purpose of procuring co-suretyship or reinsurance or of advising interested persons or mpanies.

Signed, sealed, and dated this 6th day of June, 19 91

Attest _____ (Seal)

By: Michael E. Malloy (Seal)
Assistant Secretary

_____ (Seal)

_____ (Seal)

_____ (Seal)

_____ (Seal)

_____ (Seal)

_____ (Seal)

_____ (Seal)

Pacific Gas & Electric Company (Seal)

By: Stanley T. Skinner (Seal)
STANLEY T. SKINNER
Vice Chairman of the Board

_____ (Seal)

_____ (Seal)

_____ (Seal)

_____ (Seal)

_____ (Seal)

_____ (Seal)

_____ (Seal)

_____
Name of Surety(ies)

By: _____

IMPORTANT: Print or type the name and address of each signatory to this agreement. Each signature must be acknowledged—See REVERSE HEREOF

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INDIVIDUAL AND PARTNERSHIP ACKNOWLEDGEMENT

STATE OF _____ ss.
COUNTY OF _____
On this _____ day of _____, 19____ before me personally appeared _____

to me known and known to me to be the individual(s) described in and who executed the foregoing agreement and acknowledged that _____ he _____ executed the same for the purposes, considerations and uses therein set forth as _____ h _____ free and voluntary act and deed.

Notary Public, residing at _____
(Commission expires _____)

CORPORATE ACKNOWLEDGEMENT

STATE OF California ss.
COUNTY OF San Francisco
On this 6th day of JUNE, 19 91 before me personally came
STANLEY T. SKINNER and MICHAEL E. MALEKOS *

to me known, who being by me duly sworn, did repose and say: that he resides in SAN FRANCISCO,
that he is the VICE CHAIRMAN of the PACIFIC GAS AND ELECTRIC COMPANY,
the corporation described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of the said corporation, and that he signed his name to the said instrument by like order.

*Assistant Secretary

OFFICIAL SEAL
LINDA M. ELLIOTT
NOTARY PUBLIC - CALIFORNIA
CITY AND COUNTY OF SAN FRANCISCO
My Commission Expires Sept. 24, 1993

Linda M. Elliott
Notary Public, residing at SAN FRANCISCO
(Commission expires September 24, 1993)

CORPORATE ACKNOWLEDGEMENT

STATE OF _____ ss.
COUNTY OF _____
On this _____ day of _____, 19____ before me personally came _____

to me known, who being by me duly sworn, did repose and say: that he resides in _____,
that he is the _____ of the _____,
the corporation described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of the said corporation, and that he signed his name to the said instrument by like order.

Notary Public, residing at _____
(Commission expires _____)

CORPORATE ACKNOWLEDGEMENT

STATE OF _____ ss.
COUNTY OF _____
On this _____ day of _____, 19____ before me personally came _____

to me known, who being by me duly sworn, did repose and say: that he resides in _____,
that he is the _____ of the _____,
the corporation described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of the said corporation, and that he signed his name to the said instrument by like order.

Notary Public, residing at _____
(Commission expires _____)

IMPORTANT: Attach certified copy of Resolution authorizing execution of this instrument by Corporation.

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Reliance

RECEIPT OF CONTINUING AGREEMENT OF INDEMNITY

This is to acknowledge receipt of original Continuing Agreement of

Indemnity from San Francisco
(Branch)

regarding Pacific Gas & Electric Company
(Account)

dated June 11, 1992

6-17-92 Kimberly Greenwood
(Date) (Signature)

WHITE - ORIGINAL CANARY - ACKNOWLEDGEMENT COPY PINK - BRANCH COPY
03-4153

United States Bankruptcy Court — Northern District of California (San Francisco Division)

AMENDED PROOF OF CLAIM

Name of Debtor	Case Number
Pacific Gas and Electric Company	01-30923 (DM)

NOTE: This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A request for payment of an administrative expense may be filed pursuant to 11 USC § 503

Name of Creditor (The person or other entity to whom the debtor owes money or property): Travelers Casualty and Surety Company of America and Travelers Casualty and Surety Company as Administrator for Reliance Insurance Company for itself, as successor in interest by merger with United Pacific Insurance Company, and for related Reliance Insurance Companies

☐ Check box if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy of statement giving particulars.

Name and address where notices should be sent:

Susan M. Camili
Travelers Casualty and Surety Company
One Constitution Plaza, 14 CZ
Hartford, CT 06183-9062
(860) 277-4273

G. Eric Brunstad, Jr.
Bingham McCutchen LLP
One State Street
Hartford, CT 06103-3178
(860) 240-2700

☐ Check box if you have never received any notices from the bankruptcy court in this case.
☒ Check box if the address differs from the address on the envelope sent to you by the court.

THIS SPACE IS FOR COURT USE ONLY

Account or other number by which creditor identifies debtor:

Check here if this claim ☐ replaces ☒ amends a previously filed claim, dated 9/4/2001*

1. Basis for Claim
☐ Goods sold
☐ Services performed
☐ Money loaned
☐ Personal injury/wrongful death
☐ Taxes
☒ Other (See attached Addendum)

☐ Retiree benefits as defined in 11 U.S.C. § 1114(a)
☐ Wages, salaries, and compensation (fill out below)
Your SS # _____
Unpaid compensation for services performed
from _____ (date) to _____ (date)

2. Date debt was incurred: (See attached Addendum)

3. If court judgment, date obtained:

4. Total Amount of Claim at Time Case Filed: $(See attached Addendum)
If all or part of your claim is secured or entitled to priority, also complete Item 5 or 6 below.
☐ Check this box if claim includes interest or other charges in addition to the principal amount of the claim. Attach itemized statement of all interest or additional charges.

5. Secured Claim
☐ Check this box if your claim is secured by collateral (including a right of setoff)
Brief Description of Collateral:
☐ Real Estate ☐ Motor Vehicle ☐ Other
Value of Collateral: $_____

Amount of arrearage and other charges at time case filed included in secured claim, if any:

☒ Unsecured Non-priority Claim $(See Addendum)
A claim is unsecured if there is no collateral or lien on property of the debtor securing the claim or to the extent that the value of such property is less than the amount of the claim.

6. Unsecured Priority Claim.
☒ Check this box if you have an unsecured priority claim
Amount entitled to priority $ (See attached Addendum)
Specify the priority of the claim:
☐ Wages, salaries, or commissions (up to $4,650),* earned within 90 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier - 11 U.S.C. § 507(a)(3)
☐ Contributions to an employee benefit plan - 11 U.S.C. § 507(a)(4)
☐ Up to $2,100* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use - 11 U.S.C. § 507(a)(6)
☐ Alimony, maintenance, or support owed to a spouse, former spouse, or child - 11 U.S.C. § 507(a)(7)
☒ Taxes or penalties owed to governmental units - 11 U.S.C. § 507(a)(8)
☐ Other - Specify applicable paragraph of 11 U.S.C. § 507(a)(__)
*Amounts are subject to adjustment on 4/1/04 and every 3 years thereafter with respect to cases commenced on or after the date of adjustment.

7. Credits. The amount of all payments on this claim has been credited and deducted for the purpose of making this proof of claim.
8. Supporting Documents: Attach copies of supporting documents, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, court judgments, mortgages, security agreements and evidence of perfection of lien. DO NOT SEND ORIGINAL DOCUMENTS. If the documents are not available, explain. If the documents are voluminous, attach a summary. (See attached Addendum)
9. Date-Stamped Copy: To receive an acknowledgment of the filing of your claim, enclose a self-addressed envelope and copy of this proof of claim.

THIS SPACE IS FOR COURT USE ONLY

Date: 3/03

Sign and print the name and title, if any, of the creditor or other person authorized to file this claim (attach copy of power of attorney, if any)
Travelers Casualty and Surety Company

By: _____
Jonathan B. Alter, Its Attorney

Penalty for presenting fraudulent claim: Fine of up to $500,000 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 3571.

CS 1527078.1

ADDENDUM TO AMENDED PROOF OF CLAIM OF (A) TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA AND (B) TRAVELERS CASUALTY AND SURETY COMPANY AS ADMINISTRATOR FOR RELIANCE INSURANCE COMPANY (1) FOR ITSELF, (2) AS SUCCESSOR IN INTEREST BY MERGER WITH UNITED PACIFIC INSURANCE COMPANY, AND (3) FOR RELATED RELIANCE INSURANCE COMPANIES

This Amended Proof of Claim is filed pursuant to that certain Stipulation Resolving Debtor's Objections to Claims of Travelers Casualty and Surety Company [Claims Nos. 8869, 9911, 9912, and 11335] and Order Thereon (the "**Stipulation**") dated November 8, 2002, a copy of which is attached hereto as Exhibit A.

Travelers hereby asserts its claim for attorneys' fees under the Indemnity Agreements as a general unsecured claim against Pacific Gas and Electric Company as set forth on Exhibit B hereto. This Amended Proof of Claim supplements, and does not replace, Travelers' Proof of Claim dated September 4, 2001 (Claim No. 8869).

Travelers reserves the right to further amend its Proof of Claim as it becomes known, fixed and liquidated, and for other lawful purposes.

* * *

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EXHIBIT B

COLLECTION COSTS – BINGHAM McCUTCHEN LLP
(Redacted copies of invoices are available upon request)

Invoice	Date	Fees	Cost	Total
500967	3/30/2001	$ 252.00	$	$ 252.00
506682	5/17/2001	$ 1,320.00	$	$ 1,320.00
524042	9/19/2001	$ 1.695.00	$ 23.20	$ 1718.20
527148	10/24/2001	$ 1,183.00	$ 389.23	$ 1,572.23
532574	11/29/2001	$ 1,886.85	$ 229.73	$ 2,116.58
537583	12/20/2001	$ 5,963.40	$ 188.36	$ 6,151.76
540897	1/24/2002	$ 6,698.25	$5,334.79	$12,033.04
544871	2/21/2002	$10,697.85	$1,633.08	$12,330.93
549643	3/26/2002	$ 198.90	$2,109.34	$ 2,308.24
551658	4/23/2002	$ 2,430.90	$ 154.90	$ 2,585.80
557581	6/1/2002	$13,584.60	$ 960.62	$14,545.22
561283	6/27/2002	$48,216.15	$9,329.21	$57,545.36
564680	7/30/2002	$ 543.60	$3.493.51	$ 4,037.11

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Invoice	Date	Fees	Cost -	Total
568107	8/30/2002	$15,820.20	$ 665.95	$16,486.15
571226	9/30/2002	$ 4,468.95	$ 288.20	$ 4,757.15
574910	10/30/2002	$ 3,186.45	$ 655.20	$ 3,841.65
577387	11/18/2002	$ 5,992.65	$ (2,323.40)	$ 3,669.25
581586	12/20/2002	$11,731.95	$ 4,937.13	$16,669.08
WIP		$ 3,360.50	$ 393.33	$ 3,753.83
TOTAL				**$167,693.58**

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FILED
NOV 20 2006
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 05-1429

IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR PETITIONER

G. ERIC BRUNSTAD, JR.
Counsel of Record
RHEBA RUTKOWSKI
ROBERT A. BRUNDAGE
WILLIAM C. HEUER
FRANCESCA L. MICELI
ERIC HEINING
SUKTI DHITAL
AMY LAWLER
NICHOLAS SALAZAR
BINGHAM MCCUTCHEN LLP
One State Street
Hartford, Connecticut 06103
(860) 240-2700

Counsel for Petitioner

QUESTION PRESENTED

Whether in bankruptcy cases a litigant may recover attorneys' fees arising under a contract or state statute where the issues litigated involve matters of federal bankruptcy law.

PARTIES TO THE PROCEEDING

Petitioner is Travelers Casualty & Surety Company of America ("Travelers"), as Administrator for Reliance Insurance Company for itself, as successor-in-interest by merger with United Pacific Insurance Company, and for related Reliance Insurance Companies. Travelers is owned by Travelers Home Insurance Group Holdings, Inc., which, in turn, is owned by Travelers Property Casualty Corp., which in turn is owned by The St. Paul Travelers Companies, Inc. The St. Paul Travelers Companies, Inc. is a publicly traded company. Respondent is Pacific Gas and Electric Company ("PG&E").

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PRELIMINARY STATEMENT

This matter arises out of the chapter 11 bankruptcy case of respondent Pacific Gas & Electric Company ("PG&E" or "Respondent"). Before PG&E commenced its bankruptcy case, Petitioner Travelers Casualty & Insurance Company ("Travelers" or "Petitioner") issued surety bonds on PG&E's behalf to various third parties, and PG&E executed a series of indemnity agreements in favor of Travelers. Among other things, the indemnity agreements provide that PG&E is responsible for any loss that Travelers may incur in connection with the bonds, including any attorneys' fees incurred in pursuing, protecting, or litigating Travelers' rights in connection with the bonds.

During PG&E's bankruptcy case, Travelers incurred attorneys' fees in the course of asserting its rights, objecting to its treatment under PG&E's chapter 11 plan and disclosure statement, and defending litigation that PG&E brought against Travelers in connection with the bonds. The relevant proceedings and litigation involved questions of federal bankruptcy law. Travelers filed a claim against PG&E for its attorneys' fees.

Adhering to its prior decision in *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), the Ninth Circuit held that Travelers could *not* have a claim for its attorneys' fees as a matter of law. The court reasoned that, although parties may be free to contractually allocate between them the burden of attorneys' fees incurred in litigating *state* law issues, they cannot do so with respect to litigating *federal* bankruptcy issues unless federal law specifically authorizes the allocation. Incorporating by reference its reasoning in *DeRoche v. Ariz. Indus. Comm'n (In re DeRoche)*, 434 F.3d 1188 (9th Cir. 2006), *reh'g denied*, No. 04-15258 (9th Cir. Feb. 8, 2006),[1] the Ninth Circuit determined that, even if a litigant has a general right to attorneys' fees under applicable state law, either by virtue of a contract valid under state law or by virtue of a state statute, the

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[1] A petition for writ of certiorari was filed in the *DeRoche* case and remains pending. Case No. 05-1439.

litigant's general right to fees cannot extend to fees incurred in litigating *bankruptcy* issues because federal law does not *authorize* such a recovery. Significantly, no federal statute directs or requires this result. Instead, the court applied its rule as a matter of general federal common law.

This Court should reverse the decision below for each of seven reasons. First, the *Fobian* rule has the analysis exactly backwards by requiring that federal law must *authorize* a contractual allocation of attorneys' fees in order for Travelers to hold a "claim" for its fees in bankruptcy. As this Court has explained, a creditor (such as Travelers) holds a claim for its attorneys' fees in bankruptcy if its contractual right to the fees is valid under applicable *state* law. Here, Travelers' contractual right to its attorneys' fees is valid under California law. Travelers therefore holds a "claim" for its fees for bankruptcy purposes, 11 U.S.C. § 101(5), and the proper question is whether some provision of the Bankruptcy Code expressly *disallows* Travelers' otherwise valid claim based on its state-law right, 11 U.S.C. § 502. Because no provision of the Code disallows Travelers' claim for its fees, the claim should have been allowed, and the Ninth Circuit's denial of Travelers' claim is contrary to the express requirement of the Code that a claim "shall" be allowed unless one of the *express* grounds for disallowance applies. 11 U.S.C. § 502(b).

Rather than follow this established analysis, the Ninth Circuit's *Fobian* rule creates a federal common law standard that categorically denies the validity of any contractual allocation of attorneys' fees arising from the litigation of bankruptcy issues. This is wrong. There is no general federal common law of bankruptcy governing contractual allocations of attorneys' fees, and there is no basis to conclude that bankruptcy law pre-empts state law on the question whether a party may contractually allocate attorneys' fees arising from litigation involving bankruptcy issues. Contract issues generally, and contractual allocations of attorneys' fees specifically, are governed by state law. Again, if a creditor has a contractual right to attorneys' fees that is valid under state law, the creditor holds a bankruptcy "claim" for its fees. Where, as here, no provision of the

Bankruptcy Code disallows the claim, it must be allowed in the debtor's bankruptcy case.

Second, and closely related to the first reason, the *Fobian* rule conflicts with this Court's precedents restricting the ability of the federal courts to prescribe the categorical treatment of claims in bankruptcy. As this Court has held, it is for Congress, not the courts, to define how state-law rights to payment are to be treated in bankruptcy cases. The *Fobian* rule usurps Congress's authority by concluding categorically that *no* right to attorneys' fees may be recognized in bankruptcy if the fees are incurred in the context of litigating federal bankruptcy issues.

Third, the *Fobian* rule is contrary to the historical treatment of claims for attorneys' fees in bankruptcy proceedings. Following this Court's decision in *Security Mortgage Co. v. Powers (In re Florida Furniture Co.)*, 278 U.S. 149, 154 (1928), courts applying the provisions of the statutory predecessor to the current Bankruptcy Code correctly allowed in bankruptcy cases claims for attorneys' fees incurred in pursuing bankruptcy litigation. *E.g.*, *United Merchants & Mfrs., Inc. v. Equitable Life Assurance Soc'y (In re United Merchants & Mfrs., Inc.)*, 674 F.2d 134, 137-140 (2d Cir. 1982). Because there is no reason to conclude that Congress intended to alter this historical practice, the Court should conclude that it endures.

Fourth, the *Fobian* rule is contrary to the policies and purposes of the Bankruptcy Code. A key bankruptcy policy is equality of distribution, implemented primarily through the Code's pro rata distribution procedures. Absent some express provision of the Code to the contrary, creditors' holding contractual rights to payment for attorneys' fees are no less entitled to receive pro rata distributions on account of their claims than other creditors who hold different kinds of claims. A common law rule of disallowance untethered to any express provision of the Code obviously denies equality of distribution to the holders of claims for attorneys' fees by effectively reducing their distributions to zero.

Fifth, the *Fobian* rule is impractical. It recognizes that, if the creditor's attorneys' fees relate to the litigation of *state* law issues,

a contractual right to attorneys' fees will be allowed as a valid claim in bankruptcy. It is only if the fees relate to the litigation of *federal* bankruptcy issues that the creditor cannot hold a claim. But most litigation in the bankruptcy courts involves consideration of a combination of issues of state and federal law, and it is often impractical to separate fees arising from the litigation of one issue versus the other if they occur in the same proceeding. There is no reason to conclude that Congress intended to burden the courts with the administrative quagmire of sorting fee claims on this basis.

Sixth, the *Fobian* rule leads to absurd results, as illustrated by the *DeRoche* case that the Ninth Circuit decided in tandem with the decision below. In *DeRoche*, the *debtors* asserted a claim for their attorneys' fees against an agency of the State of Arizona under a state statute that rendered the agency liable for the DeRoches' fees arising from the agency's unsuccessful litigation against the DeRoches in federal bankruptcy court. The litigation involved questions of bankruptcy law. Applying *Fobian*, the court ruled that a claim for attorneys' fees arising from the litigation of bankruptcy issues is not valid unless authorized by federal law, and the court denied the DeRoches' claim. The court's application of the *Fobian* rule in the *DeRoche* case yielded the absurd result that a State is barred from directing that its own agency must pay the attorneys' fees incurred by two of its citizens when the agency unsuccessfully sues them in federal court.

Seventh, the *Fobian* rule is inequitable. In general, commercial parties are free to allocate the burden of attorneys' fees contractually, and those that do price their goods and services accordingly. The *Fobian* rule categorically eviscerates this market practice, apparently for the sake of attempting to "equalize" treatment among creditors generally. But "[e]quality among creditors who have lawfully bargained for different treatment is not equity but its opposite," *Chemical Bank v. Kheel*, 369 F.2d 845, 848 (2d Cir. 1966) (Friendly, J., concurring), and the wholesale elimination of a right to attorneys' fees as part of a creditor's claim is nothing more than an inequitable discrimination.

The *Fobian* rule is an impermissible intrusion upon the text, structure, history, and purpose of the Bankruptcy Code, and an unwarranted federalization of contractual rights. For all the foregoing reasons, this Court should reverse the decision below.

OPINIONS BELOW

The opinion of the court of appeals, Pet. App. 1a, is unpublished, but can be found at 2006 WL285977 (No. 04-15605) (9th Cir. Feb. 7, 2006). The opinion of the district court, Pet. App. 4a, is also unpublished, as is the opinion of the bankruptcy court, Pet. App. 20a.

JURISDICTION

The court of appeals entered its judgment on February 7, 2006. Petitioner timely filed its petition for writ of certiorari on May 8, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS OF LAW

The following statutory provisions and rules are relevant to this matter:[2] 11 U.S.C. §§ 101(5), (12); 501; 502; 509; 1125; and FED. R. BANKR. P. 3003.

STATEMENT OF THE CASE

A. Travelers' Issuance Of Surety Bonds On PG&E's Behalf And PG&E's Execution Of The Indemnity Agreements

For many years prior to PG&E's bankruptcy filing, Travelers issued a variety of surety bonds on PG&E's behalf to various third parties, assuring PG&E's performance of a broad variety of obligations. These bonds include the $100 million surety bond ("Bond") involved in this matter that Travelers issued on PG&E's behalf to the State of California, Department of Industrial

[2] The full text of these statutory provisions and rule appears in the appendix accompanying the petition for writ of certiorari. Pet. App. 27a.

Relations. Supplemental Joint Appendix ("SJA") 6.[3] The Bond assured PG&E's payment of workers' compensation benefits to PG&E's injured employees.

Historically, the State of California required companies such as PG&E to assure the payment of workers' compensation benefits in one of two basic ways: (1) by purchasing workers' compensation insurance; or (2) by meeting certain "self-insurance" requirements. To qualify for "self-insurance," a company such as PG&E was obligated, among other things, to post security with the State, including one or more surety bonds, assuring the payment of mandatory workers' compensation benefits. CAL. LABOR CODE §§ 3700 & 3701(e) (West 2003). The State conditioned PG&E's ability to conduct business as a self-insured employer on its posting of adequate workers' compensation bonds. Had PG&E failed to do so, it would have been required to purchase insurance, which typically costs many times the expense of a surety bond, or cease operations.

In connection with Travelers' agreement to issue bonds on behalf of PG&E (including the $100 million workers' compensation Bond), PG&E executed indemnity agreements in favor of Travelers. Specifically, PG&E executed a Continuing Agreement of Indemnity dated June 11, 1992, and a Continuing Agreement of Indemnity dated June 6, 1991 (collectively, the Indemnity Agreements"). SJA 4, 9-17. Under the terms of these agreements, PG&E is obligated to indemnify Travelers in full for any loss that Travelers may sustain in connection with the bonds. *Id.* The agreements are worded broadly, and include a provision that PG&E is obligated to reimburse Travelers for any and all attorneys' fees that Travelers incurs in connection with the bonds, including any of Travelers' efforts to enforce or protect its rights with respect to the bonds:

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[3] The Bond was issued originally by The Reliance Insurance Company ("Reliance"). Travelers subsequently became the administrator for Reliance. Travelers also issued surety bonds on behalf of PG&E.

> NOW, THEREFORE, in consideration of the execution of any [of the surety bonds] . . . we, the Undersigned [PG&E], agree and bind ourselves . . as follows . . . [to] indemnify, and keep indemnified, and hold and save harmless the Surety [Travelers] against all demands, claims, loss, costs, damages, expenses and attorney's fees whatever and all liability therefor, sustained or incurred by the Surety [Travelers] by reason of executing . . . [the Bonds] . . . or sustained or incurred by reason of making any investigation on account thereof, prosecuting or defending any action brought in connection therewith, . . . recovering or attempting to recover any salvage in connection therewith or enforcing by litigation or otherwise any of the agreements herein contained.

SJA 9,13 ¶ "SECOND."

The fundamental concept behind this broad indemnity provision is to ensure that any loss that Travelers might sustain in connection with the bonds would be borne by PG&E, rather than Travelers. As explained below, this is fundamental to the suretyship relationship -- that the party on whose behalf the surety issues its bond is responsible for holding the surety harmless for any and all loss. Among other reasons, to the extent that sureties are required to bear unreimbursed losses in connection with their bonds, this will inevitably increase the cost of issuing bonds and either make them more expensive or less available, harming industries that rely on surety bonds to conduct their businesses.

B. PG&E's Bankruptcy Filing And Travelers' Proof Of Claim

On April 6, 2001 (the "Petition Date"), PG&E filed a petition for relief under chapter 11 of the Bankruptcy Code. By operation of law, when a debtor commences a bankruptcy case, a bankruptcy estate is created consisting of all of the debtor's property wherever located. 11 U.S.C. § 541. In chapter 11 cases, a trustee is not usually appointed, and the debtor typically continues to manage its business as the "debtor in possession" of the bankruptcy estate. 11 U.S.C. §§ 1101(1) (defining "debtor in possession" in a chapter 11 case), 1107 (prescribing duties of debtor in possession, including

duties of trustee), 1108 (authorizing operation of business). Consistent with these provisions, PG&E continued in possession of its property, and continued to conduct its business, following its bankruptcy filing.

Shortly after the Petition Date, PG&E obtained an order from the bankruptcy court authorizing, but not obligating, it to continue paying workers' compensation benefits. Joint Appendix ("JA") 24a. Because the order only *authorized* PG&E to pay benefits, it did not ensure that PG&E would, in fact, continue to pay benefits to its injured employees, and the order did not bind PG&E to continue paying benefits after it emerged from bankruptcy (only PG&E's confirmed plan could bind PG&E in that fashion). In other chapter 11 cases in which the debtor has been authorized at the beginning of its case to pay workers' compensation benefits, the debtor has discontinued doing so during the course of the case, requiring the surety to pay the relevant benefits under its bond. *See Aetna Cas. & Sur. Co. v. Clerk of U.S. Bankruptcy Court (In re Chateaugay Corp.)*, 89 F.3d 942, 945-46 (2d Cir. 1996) (noting that, in spite of obtaining bankruptcy court authorization to continue paying workers' compensation benefits, the debtor stopped paying during the course of its case and the surety was required to pay $38 million to cover the debtor's obligations).

Under the Bankruptcy Code, all pre-petition rights to payment against the debtor constitute "claims" against the debtor's bankruptcy estate. 11 U.S.C. § 101(5); *Cohen v. De La Cruz*, 523 U.S. 213, 218 (1998) ("a 'claim' is defined . . . as a 'right to payment,' . . . and a 'right to payment,' we have said, 'is nothing more nor less than an enforceable obligation'") (quoting *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559 (1990)).[4] Any creditor holding a pre-petition claim, whether contingent or otherwise, is entitled to file a "proof of claim" with the bankruptcy court. 11 U.S.C. §§ 101(5), 101(10), 501(a), 502(b); FED. R.

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[4] The term "pre-petition" refers to rights or events arising or occurring *before* the debtor files a bankruptcy petition. The term "post-petition" refers to rights or events arising or occurring *after* the debtor files.

BANKR. P. 3001, 3002; *see Katchen v. Landy*, 382 U.S. 323, 336 (1966) ("bankruptcy . . . converts the creditor's legal claim into an equitable claim to a pro rata share of the *res*").[5] Only creditors who file proofs of claim (or whose claims are scheduled and listed by the debtor as undisputed) may receive distributions from the debtor's bankruptcy estate. FED. R. BANKR. P. 3002(a), 3003(b), (c)(2); *New York v. Irving Trust Co.*, 288 U.S. 329, 333 (1933).

Shortly after PG&E commenced its bankruptcy case, the bankruptcy court established a "bar date" setting a deadline for the filing of proofs of claim against PG&E. FED. R. BANKR. P. 3003(c)(3). A bar date is significant because a creditor who fails to file a proof of claim by the deadline is generally not entitled to vote on the debtor's chapter 11 plan of reorganization and may not receive any distributions from the debtor on account of any claim the creditor may have. FED. R. BANKR. P. 3003(c)(2).

Although at the time of the "bar date" Travelers had not been called upon to make any payment under the Bond, Travelers was nonetheless obligated to file a proof of claim if it wanted to preserve its rights with respect to its outstanding $100 million Bond. By virtue of the Indemnity Agreements and Travelers' rights as a surety, Travelers held a pre-petition contractual indemnity claim against PG&E for any loss that Travelers might sustain in connection with the Bond, including a pre-petition contractual right to any attorneys' fees that it may incur in connection with the bonds. Under the Bankruptcy Code, Travelers' pre-petition contractual claims were "contingent" in the sense that they were "contingent" upon Travelers actually incurring any loss at a future point in time, such as by having to pay workers' compensation benefits in the future, or by incurring attorneys' fees in the future in connection with enforcing or protecting its rights. Although contingent, Travelers' pre-petition contractual right to payment properly constitutes a claim because

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[5] The Bankruptcy Code defines "creditor" as a person holding a claim that arises before the debtor commences a bankruptcy case. 11 U.S.C. § 101(10).

the Bankruptcy Code expressly includes in the definition of "claim" any "right to payment, whether or not such right is . . . contingent." 11 U.S.C. § 101(5). As courts have long recognized, a proof of claim of this type (i.e., involving contingent claims) must be timely filed in the debtor's bankruptcy case or the creditor will be forever barred from recovering any amount from the debtor if the contingency ripens later. *Employee Ret. Corp. v. Osborne (In re THC Fin. Corp.)*, 686 F.2d 799, 802, 804 (9th Cir. 1982) (creditor who failed to file proof of contingent claim was barred from recovery).

The purpose of the bar date rule and the Bankruptcy Code's broad definition of the concept of a "claim" is to ascertain all of the debtor's liabilities, whether contingent or otherwise, in order to address them comprehensively in the bankruptcy proceeding. Accordingly, a creditor such as a surety who may have to make payment to a third party in the future on account of a pre-petition surety bond must file a proof of claim setting forth its pre-petition contingent contractual right to payment against the debtor arising from the bond even though the surety has not yet made any payment or otherwise incurred any loss. Similarly, if a creditor has a pre-petition contractual right to attorneys' fees, but has not yet incurred the fees at the time the debtor files its bankruptcy case, the creditor must nonetheless file a proof of claim establishing its contingent claim based on its pre-petition contractual right. Consistent with these requirements, on or about September 5, 2001, Travelers timely filed a proof of claim attaching copies of its contractual agreements with PG&E. SJA 1-17.

In its proof of claim, Travelers explained briefly its rights as a surety. First, Travelers explained that, in the event it must ever pay benefits under the Bond, Travelers has a right of indemnification against PG&E. SJA 3-4. Under applicable law, surety bonds are not policies of insurance; they are secondary obligations. *Nat'l Tech. Sys. v. Superior Court of Los Angeles County*, 118 Cal. Rptr. 2d 465, 477 (Cal. Ct. App. 2002). Accordingly, in the event that a surety (here Travelers) incurs any loss in connection with its bond, the surety is entitled to recover its loss from its principal (here PG&E). *Howco Leasing Corp. v.*

Alexander Dispos-Haul Sys., Inc. (In re Alexander Dispos-Haul Sys., Inc.), 36 B.R. 612, 616 (Bankr. D. Or. 1983) (the surety is entitled "to compel the principal debtor to repay immediately all or any part of the principal debt which the surety has paid"). This right exists independently of any contractual arrangement. *See* 74 AM. JUR. 2D SURETYSHIP, § 182 (1974) ("Where the surety has satisfied [its obligation], the principal is bound to indemnify him, irrespective of any express contract of indemnity."). In this case, as noted, the Indemnity Agreements specifically provide for Travelers' right of indemnity.

Second, Travelers explained that, in the event that it must pay benefits under the Bond, Travelers also has a right of subrogation. SJA 4. The doctrine of subrogation entitles a surety to "step into the shoes" of the persons whom the surety pays (here the injured workers) in order to assert *their* claims against the principal (here PG&E). CAL. CIV. CODE § 2848 (West 2003) ("A surety, upon satisfying the obligation of the principal, is entitled to enforce every remedy which the creditor then has against the principal to the extent of reimbursing what he has expended."); *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 138 (1962) (subrogation permits a performing surety to "protect itself by resort to the same securities and same remedies which had been available to the [party whom the surety has paid] for its protection"); *Allen v. See (In re Simmons)*, 196 F.2d 608, 610 (10th Cir. 1952) ("It is well settled that where one secondarily liable is called upon to make good on his obligation and pays the debt, he steps into the shoes of the former creditor [and] becomes subrogated to all the rights of the creditor against the principal debtor."). Thus, under the doctrine of subrogation, in the event that Travelers were ever called upon to pay workers' compensation benefits to PG&E's injured employees, Travelers would have the right to step into the shoes of the workers and assert their compensation claims against PG&E in order to recover whatever amounts Travelers pays.[6]

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[6] The surety's right of subrogation is preserved in bankruptcy. 11 U.S.C. § 509(a). A right of subrogation is not itself a "claim" against the debtor,

Under the Bankruptcy Code, in the event a creditor (such as an injured employee) fails to file a proof of claim, the surety who is obligated under its bond to pay the creditor on the debtor's behalf may file the claim in the creditor's stead. 11 U.S.C. § 501(b). In this case, Travelers, in addition to filing a claim for itself, also filed a claim on behalf of all of the workers who hold workers' compensation claims against PG&E and whom Travelers might someday have to pay. SJA 5. By doing so, Travelers protected both the rights of the employees *and* its own interests.

C. Travelers' Objections To PG&E's Disclosure Statement

During its bankruptcy case, PG&E filed a disclosure statement ("Disclosure Statement") describing its proposed chapter 11 plan of reorganization ("Plan"). 11 U.S.C. § 1125 (stating requirements for a disclosure statement). The purpose of a disclosure statement is to provide creditors with information regarding the proposed treatment of their claims and rights. *Prudential Ins. Co. of Am. v. Monnier (In re Monnier Bros.)*, 755 F.2d 1336, 1342 (8th Cir. 1985) ("The primary purpose of a disclosure statement is to give the creditors the information they need to decide whether to accept the plan."). Travelers objected to PG&E's Disclosure Statement

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but rather constitutes the surety's right to take assignment of the claim of the party whom the surety pays (here the injured workers to whom Travelers may pay benefits). *In re Bessemer Materials, Inc.*, 225 F. Supp. 314, 318 (N.D. Ala. 1963) ("subrogation . . . is merely a form of assignment by operation of law"). Through subrogation, the surety is entitled to assert, not only the face amount of the claim of the party whom the surety pays, but also all of the payee's collection rights, as though the surety were the payee. *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 138; *Pandora Indus., Inc. v. Paramount Commc'ns Inc. (In re Wingspread Corp.)*, 145 B.R. 784, 791 (Bankr. S.D.N.Y. 1992) ("Under the doctrine of subrogation, a subrogee is entitled to assert any priority or special right of the subrogor."), *aff'd*, 992 F.2d 319 (2d Cir. 1993); *Niagara Fire Ins. Co. v. United States*, 76 F. Supp. 850, 855 (S.D.N.Y. 1948) ("[B]y the operation of the doctrine of subrogation, the subrogee becomes the owner of the very rights of the individual who suffered injury to his person or property; they are not similar or analogous but identical.").

because it did not adequately describe how PG&E's plan would treat its workers' compensation obligations or Travelers' rights as surety. JA 30a-33a. Recognizing the Disclosure Statement's inadequacies, the bankruptcy court required PG&E to specify the treatment of workers' compensation claims and Travelers' rights. JA 43a-45a, 48a-49a.

At the hearing on the adequacy of the Disclosure Statement, Travelers explained the filing of its proof of claim, its role as surety, and its rights. JA 35a-51a. Travelers also explained the importance of PG&E's failure to disclose the proposed treatment of the claims held by workers entitled to receive workers' compensation benefits:

> Traditionally, what happens is that the debtor wants to render [its workers' compensation claims] unimpaired [i.e., unaffected by the debtor's bankruptcy case], because if the debtor doesn't render these unimpaired under the plan, [the debtor] may not be able to get self-insured surety coverage, the state may not allow them to get that post-confirmation, and as I note under the debtor's disclosure statement, they intend to go for self-insurance, but like I said at the outset, this is an issue which has to be gotten right, in order for their potential program to work. It also has to be gotten right under 1125, because we need to know what's happening to the claims.

JA 40a-41a. The bankruptcy court agreed, and asked the representative of PG&E's corporate parent, PG&E Corporation, the principal proponent of the Plan (the "Parent"), what it intended to do with the claims. JA 41a ("But let's take a simple answer. What is the fate of pre-petition worker's comp claimants under the post-confirmation regime?"). The Parent replied: "[W]hat we're prepared to do, regardless of what the current state of affairs is, is just to add a statement that makes clear that the claims of the workers themselves will pass through with the reorganized debtor remaining obligated to pay for them." *Id.* Travelers then inquired: "The magic words I'm hoping to hear, perhaps I am hearing them, is that they're rendered unimpaired." JA 42a. The bankruptcy court then stated: "Unimpaired." *Id.* The Parent replied: "Yes."

Id.; see 11 U.S.C. § 1124 (defining the concept of "unimpaired" treatment under a chapter 11 plan as express treatment in the plan that leaves a creditor's non-bankruptcy rights unaffected by the debtor's bankruptcy case); *Bank of Am Nat'l Trust & Savings Ass'n v. 203 North LaSalle St. P'ship*, 526 U.S. 434, 442 n. 14 (1999) ("Claims are unimpaired if they retain all of their prepetition legal, equitable and contractual rights against the debtor.").

Travelers then inquired about the treatment of its subrogation rights: "What we'd also like to know is whether our subrogation rights are being rendered unimpaired under 509(a). Simply put, that solves the problem." JA 44a. The bankruptcy court asked: "Can we have a position on that?" *Id.* The Parent replied: "Your Honor, I don't believe a subrogation right is a claim against the debtor. It's the right to step into someone else's claim and whatever that treatment is, it is." *Id.* The bankruptcy court stated: "Yeah, that's what I thought too. You don't have a separate claim, you just take over the claim." JA 44a. To this Travelers replied: "As long as nothing in the plan will, or purports to impair Traveler's subrogation rights, I'll settle for that." JA 45a.

Critically, the bankruptcy court then stated: "Well, can we solve that problem, then, by you're [sic] defining this new class to be the claimants, but then provide and/or Travelers to the extent that by subrogation it takes over the claim, words to that effect?" *Id.* The Parent replied: "Certainly." *Id.* PG&E likewise replied: "Certainly." *Id.*

Following this exchange, the parties left the courtroom and negotiated particular language to be inserted into the Disclosure Statement and Plan to implement this agreement. JA 51a. Specifically, the parties agreed that the Plan would provide that the claims of workers to workers' compensation benefits would be placed in their own class under the Plan and rendered unimpaired, and that the Plan would also leave unimpaired any right that Travelers would have to be subrogated to the claims of the workers in the event Travelers were ever called upon to make payment under the Bonds (the "Negotiated Language"). This Negotiated Language appeared in the next versions of the Disclosure

Statement and Plan and provided, with respect to Travelers' subrogation rights, as follows: "Nothing in th[e] Disclosure Statement[s] or Plan[s] shall affect . . . the subrogation rights . . . of any surety of pre-petition or post-petition Workers' Compensation Claims." JA 54a ¶ 4.21, 56a ¶ 11.21, 60a-62a ¶ 4, 64a ¶ 22, 66a ¶ 21.

The Negotiated Language reflected the straightforward resolution of a problem critical to PG&E's ability to reorganize, and also important to the protection of Travelers' rights. In order to preserve its ability to maintain its self-insured status, PG&E provided that it would remain fully obligated to pay its workers' compensation obligations. Similarly, in the event that PG&E were to default in the future on these obligations, and Travelers were to make payment under its Bond, Travelers would be entitled to step into the workers' shoes through its right of subrogation and enforce the workers' rights against PG&E to recover whatever Travelers might pay -- including the workers' right under the Plan to have their claims paid. *In re Wingspread Corp.*, 145 B.R. 784, 791 (Bankr. S.D.N.Y. 1992) ("Under the doctrine of subrogation, a subrogee is entitled to assert any priority or special right of the subrogor."), *aff'd*, 992 F.2d 319 (2d Cir. 1993). Because the Bankruptcy Code does not permit a debtor to avoid a surety's subrogation rights (indeed, section 509(a) of the Code expressly preserves them), PG&E did not give up anything. On the contrary, by providing that it would honor its workers' compensation obligations in full, PG&E not only preserved its ability to retain its self-insured status after it emerged from bankruptcy, it enhanced its ability to obtain workers' compensation bonds from its sureties to qualify for self-insured status.

D. PG&E's Unilateral Modification Of The Negotiated Language And Pursuit Of Litigation Against Travelers

Had PG&E left the Negotiated Language in its Plan and Disclosure Statement as expressly agreed, there would have been no subsequent litigation over Travelers' subrogation rights. However, for reasons that have never been explained, PG&E reneged on its agreement and without warning unilaterally modified the Negotiated Language to state that "[n]othing herein

shall affect . . . the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of any such subrogation rights [of Travelers]." JA 54a ¶ 4.21, 56a ¶ 11.21, 60a-62a ¶ 4, 64a ¶ 22, 66a ¶ 21.

Moreover, on or about March 18, 2002, PG&E commenced litigation against Travelers by filing an objection to Travelers' proof of claim (the "Objection"). JA 67a. In its Objection, PG&E lumped together all of Travelers' rights and argued that *all* had to be disallowed. JA 69a-80a. In addition, PG&E separately argued that Travelers' reimbursement rights had to be disallowed because they are contingent. JA 69a-75a. PG&E also separately argued that Travelers' subrogation rights had to be "disallowed," did not exist, and "are not valid." JA 69a-80a. Further, PG&E asked the court to disallow the claims that Travelers had filed on behalf of the injured workers under section 501(b) of the Code. JA 76a-79a. If PG&E had been successful in its Objection, all of Travelers' rights against PG&E could have been extinguished or impaired even though Travelers remained liable to third parties under its Bond.

By unilaterally modifying the Negotiated Language in the Plan and by commencing litigation against Travelers with the filing of its Objection, PG&E clearly challenged and sought to eliminate or impair Travelers' reimbursement and subrogation rights. Compelled to defend its rights, Travelers opposed the Objection and objected to the Plan. JA 82a-102a.

E. The Parties' Stipulation

Following extensive negotiations, Travelers and PG&E entered into a stipulation (the "Stipulation") to "fully resolve all objections to the Claims without further litigation." JA 106a. Travelers agreed to the disallowance of its direct reimbursement claim (other than for its attorneys' fees), *expressly subject to* Travelers' right to seek reconsideration and allowance in the event that Travelers is ever obligated to make payment under its Bond. JA 107a; *see* 11 U.S.C. § 502(j) (providing for the reconsideration of a claim that has been disallowed if the claim should be allowed in the future). Thus, in the event that Travelers ever has to make payment under its $100 million Bond, Travelers retains the right to seek recovery

from PG&E under the Indemnity Agreements, notwithstanding the disallowance. Travelers' subrogation rights, including any priority to which Travelers may be subrogated, are also expressly preserved. JA 108a ("To the extent that Travelers is subrogated to the claim of any obligee under any of its Surety Bonds, Travelers shall hold such claim as a general unsecured creditor, provided that, to the extent that the claim in the hands of the obligee is entitled to priority, Travelers shall be entitled to the same priority with respect to such claim, except as provided in section 507(d) of the Bankruptcy Code."). Finally, PG&E remained obligated under its Plan to pay all of its workers' compensation obligations in full.

PG&E's failure to provide adequate disclosure until after litigation; its unilateral decision to alter the Negotiated Language in the Plan and Disclosure Statement; and its needless litigation with Travelers thereafter, caused Travelers to incur significant attorneys' fees in the defense of its rights. If Travelers had not acted to protect its rights and defend the litigation that PG&E commenced, Travelers' rights and claims against PG&E may have been discharged or otherwise eliminated or impaired, even though Travelers remained liable on its Bond. *See, e.g.*, 11 U.S.C. § 1141(d) (discharging all claims except those that are preserved in the confirmed chapter 11 plan of reorganization); FED. R. BANKR. P. 7055 (authorizing bankruptcy court to enter default judgments); *see also Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 459 (2004) (Thomas, J., dissenting) (if State acting as a creditor "does not oppose the debtor's [request to eliminate the State's rights as a creditor], the Bankruptcy Court is authorized to enter a default judgment" in the debtor's favor). Preserving Travelers' contractual right to recover its fees, the Stipulation expressly provides: "Subject to the right of a party in interest to object as provided herein, Travelers may assert its claim for attorneys' fees under the Indemnity Agreements as a general unsecured claim against PG&E." JA 108a-109a. On November 8, 2002, the bankruptcy court approved the Stipulation. JA 110a.

F. Travelers' Amended Proof Of Claim And PG&E's Objection

Pursuant to the Stipulation, Travelers filed its amended proof of claim (the "Amended Claim") on or about January 6, 2003, seeking to recover the attorneys' fees it incurred in protecting its rights during the course of PG&E's chapter 11 case, including fees incurred in pursuing its objection to the Disclosure Statement and those incurred in defending against PG&E's Objection to Travelers' rights and claims. SJA 18-21. PG&E objected to the Amended Claim, contending, *inter alia*, that Travelers could not recover attorneys' fees for bankruptcy-related matters (the "Second Objection"). JA 117a-119a. On or about May 12, 2003, at PG&E's request, Travelers provided PG&E with additional information regarding its fees, including a break-down of the fees into separate categories and an explanation of why PG&E is properly liable for these fees. JA 120a-124a. Travelers also withdrew certain expenses to which PG&E specifically objected. *Id.*

G. The Bankruptcy Court's Ruling

At a hearing held on July 11, 2003, the bankruptcy court sustained PG&E's Second Objection solely on the legal ground that Travelers could not assert a claim for attorneys' fees under applicable Ninth Circuit precedent. Pet. App. 23a-25a. While recognizing that Travelers had the right to protect its interests, *see* Pet. App. 24a-25a, the court nonetheless ruled from the bench that Travelers' claim for attorneys' fees would be disallowed as a matter of law because the fees were incurred in the context of adjudicating bankruptcy-related issues, *id.* In reaching its conclusion, the court relied on the Ninth Circuit's decision in *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), and subsequent cases following *Fobian*. *E.g., Renfrow v. Draper*, 232 F.3d 688 (9th Cir. 2000); *Am. Express Travel Related Servs. Co. v. Hashemi (In re Hashemi)*, 104 F.3d 1122 (9th Cir. 1997); *Ford v. Baroff (In re Baroff)*, 105 F.3d 439 (9th Cir. 1997).

H. The District Court's Ruling

On appeal, the district court affirmed on the same ground as the bankruptcy court. Pet. App. 10a-19a. The district court observed that the bankruptcy court did not reach any other issue

regarding Travelers' claim, such as the issue of the reasonableness of Travelers' fees. Pet. App. 9a. The court stated: "This is because the bankruptcy court ultimately found that Travelers' claim for attorneys' fees should be disallowed because 'as a matter of bankruptcy law, they cannot be assessed against the Debtor in any amount.'" *Id.* (quoting bankruptcy court's decision). The district court similarly relied on the Ninth Circuit's *Fobian* rule and its progeny.

I. The Ninth Circuit's Ruling

On further appeal, the Ninth Circuit affirmed. In doing so, it largely incorporated by reference its reasoning in *DeRoche v. Ariz. Indus. Comm'n (In re DeRoche)*, 434 F.3d 1188 (9th Cir. 2006), *reh'g denied*, No. 04-15258 (9th Cir. Feb. 8, 2006). Pet. App. 2a-3a. Applying *Fobian*, the Ninth Circuit found that a contractual right to attorneys' fees is enforceable only "if state law governs the substantive issues raised in the proceedings." *Id.* Stating that "attorneys' fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law,'" the Ninth Circuit held that Travelers could not recover its attorneys' fees because the dispute arose in connection with PG&E's Disclosure Statement, Plan, and objections to Travelers' claims and rights. *Id.*

SUMMARY OF ARGUMENT

The decision below impermissibly eviscerated Travelers' right to its attorneys' fees in PG&E's bankruptcy case. Travelers' contractual right to its attorneys' fees is valid under applicable state law. Pursuant to section 101(5) of the Bankruptcy Code, Travelers' state-law, contractual right to recover its fees properly constitutes a "claim" for bankruptcy purposes. 11 U.S.C. § 101(5). Pursuant to section 502 of the Code, the bankruptcy court was required to allow Travelers' claim for its fees because none of the express grounds for disallowance apply. 11 U.S.C. § 502(b). The Ninth Circuit's application of its *Fobian* rule in this case impermissibly overrides the text of the Code and is likewise contrary to this Court's precedents recognizing that, in determining whether a creditor has a bankruptcy "claim," a creditor's contractual entitlement to attorneys' fees is, in the first instance, an issue of state law.

The Ninth Circuit's disregard for the Code's text cannot be justified on grounds of pre-emption. There is no express pre-emption here. Nor can the Ninth Circuit's *Fobian* rule be justified on the basis of implied pre-emption. As this Court has held, the Code *utilizes* state law in determining the substance of a creditor's "claim" for bankruptcy purposes. Under the circumstances, there is no reason to conclude that, at the same time, bankruptcy law pre-empts state law for the same purpose.

Nor is there any reason for the creation of a rule of general federal common law requiring the denial of claims for attorneys' fees where the fees arise from the litigation of federal bankruptcy issues. There is no conflict between the Bankruptcy Code and state law on the question whether a contractual right to attorneys' fees properly constitutes a "claim" under the Code. Likewise, there is no other reason to create a common law rule denying claims for fees where, as here, Congress has specified the grounds for the disallowance of claims and has directed that, except for the expressly enumerated grounds, claims "shall" be allowed. 11 U.S.C. § 502(b).

The *Fobian* rule is also contrary to this Court's precedents restricting the ability of federal courts to prescribe the categorical treatment of claims in bankruptcy. The power to prescribe categorical rules of allowance or disallowance is reserved for Congress alone. In addition, the Ninth Circuit's rule conflicts with the historical treatment of claims for attorneys' fees in bankruptcy cases. Following this Court's decision in *Security Mortgage Co. v. Powers (In re Florida Furniture Co.)*, 278 U.S. 149, 154 (1928), courts applying the provisions of the statutory predecessor to the current Bankruptcy Code correctly allowed claims for attorneys' fees incurred in pursuing bankruptcy litigation. There is no indication that Congress intended to alter this historical practice, and the Court should conclude that it endures.

The *Fobian* rule is contrary to the central bankruptcy policy of equality of distribution. By denying Travelers' claim outright, the Ninth Circuit's rule effectively reduced Travelers' recovery to zero, while other creditors will receive payment on their claims -- including those with contractual claims for attorneys' fees incurred

in litigating *state*-law issues. A result that so fundamentally erodes the salient bankruptcy policy of equality of distribution should stem from an express provision of the Code, not a judge-made rule untethered to the statutory text.

The *Fobian* rule is impractical. The rule denies claims for contractual rights to attorneys' fees incurred in litigating federal bankruptcy issues, but not those incurred in litigating state-law issues. In many instances in bankruptcy it is difficult (if not impossible) to sort claims for fees on this basis, imposing an unwarranted burden on the bankruptcy courts.

The *Fobian* rule also leads to absurd results. This is perhaps best illustrated by the Ninth Circuit's application of the rule in *DeRoche v. Ariz. Indus. Comm'n (In re DeRoche)*, 434 F.3d 1188 (9th Cir. 2006). There the court reached the absurd result that, as a matter of general federal common law, a State is barred from directing that its own agency must pay the attorneys' fees incurred by two of its citizens when the agency unsuccessfully sues them in federal court.

Finally, the *Fobian* rule is inequitable because it eviscerates a common commercial practice -- that of contractually allocating attorneys' fees -- for no valid reason. Because the rule conflicts with the text, history, policy, and structure of the Bankruptcy Code and is contrary to this Court's precedents, the decision below must be reversed.

ARGUMENT

A. Travelers' Claim For Attorneys' Fees Is Allowable Under The Plain Text Of The Bankruptcy Code.

Travelers incurred attorneys' fees in pursuing, protecting, and defending its rights in connection with its $100 million Bond. In particular, Travelers took steps to ensure that, in the event Travelers is ever required to pay workers' compensation benefits under its Bond, it will be able to recover from PG&E the full amount of what it has paid. Travelers did not seek to obtain a present payment from PG&E for amounts that Travelers may have to pay in the future. Rather, Travelers simply sought to protect its ability to recover from PG&E in the event it must ever pay benefits

under the Bond, and to recover its attorneys' fees incurred in protecting its rights and defending against litigation that PG&E commenced to impair those rights.

Contractual indemnity provisions of the kind at issue in this case, including those that allocate liability for attorneys' fees, are valid and enforceable under California law. *Port of Stockton v. Western Bulk Carrier KS*, 371 F.3d 1119, 1121 (9th Cir. 2004) ("Under California law, contractual attorneys' fee provisions are generally enforceable.") (citing CAL. CIV. PROC. CODE § 1021 ("Except as attorney's fees are specifically provided for by statute, the measure and mode of compensation of attorneys and counselors at law is left to the agreement, express or implied, of the parties . . . .")). Because Travelers holds a pre-petition contractual right to payment of its attorneys' fees that is valid under state law, Travelers holds a "claim" for bankruptcy purposes. 11 U.S.C. § 101(5). Because Travelers holds a "claim" for its fees within the meaning of section 101(5) of the Bankruptcy Code, its claim must be allowed unless some provision of the Code affirmatively disallows it. 11 U.S.C. § 502. No provision of the Code even remotely purports to disallow Travelers' claim, and the courts below were obligated to follow the mandate of the statutory text. 11 U.S.C. § 502(b). Because the Ninth Circuit's *Fobian* rule represents an invalid reworking of Congress's clear statutory regime, it must be rejected.

1. Travelers' contractual right to recover its attorneys' fees from PG&E is a "claim" under the Bankruptcy Code.

This Court has explained repeatedly that, in construing and applying the Bankruptcy Code, a court must begin with the statutory text. *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004) ("The starting point . . . is the existing statutory text."). Moreover, "when the statute's language is plain, the sole function of the courts -- at least where the disposition required by the text is not absurd -- is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (internal quotations omitted); *see also Rake v. Wade*, 508 U.S. 464, 471 (1993); *Connecticut Nat'l Bank v. Germain*, 503

U.S. 249, 254 (1992); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). Similarly, a court must apply the provisions of the Code as written and refrain from engrafting limitations that do not appear on its face. *E.g.*, *Lamie*, 540 U.S. at 1032; *Hartford Underwriters*, 530 U.S. at 7; *Germain*, 503 U.S. at 254; *United States v. Locke*, 471 U.S. 84, 95 (1985) (courts do not have "carte blanche to redraft statutes in an effort to achieve that which Congress is perceived to have failed to do").

Under the plain terms of the Bankruptcy Code, Travelers' contractual right to its attorneys' fees properly constitutes a "claim" against PG&E. 11 U.S.C. § 101(5). To begin with, section 101(5) of the Code defines the term "claim" to mean any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5). The Court has explained that, as defined in section 101(5), the term "claim" is an expansive concept: "a 'claim' is defined . . . as a 'right to payment,' . . . and a 'right to payment,' we have said, 'is nothing more nor less than an enforceable obligation.'" *Cohen*, 523 U.S. at 218 (quoting *Davenport*, 495 U.S. at 559). The Court has similarly observed that, as used in the Code, the terms "claim" and "debt" are interchangeable -- the term "debt" being defined simply as "liability on a claim." 11 U.S.C. § 101(12); *see Davenport*, 495 U.S. at 558 ("This definition reveals Congress' intent that the meanings of 'debt' and 'claim' be coextensive."). These definitions reflect "Congress' broad rather than restrictive view of the class of obligations that qualify as a 'claim' giving rise to a 'debt.'" *Id.* (citing H.R. Rep. No. 95-595, at 309 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 6266 (describing definition of "claim" as the "broadest possible" and noting that the Bankruptcy Code "contemplates that all legal obligations of the debtor . . . will be able to be dealt with in the bankruptcy case").

The Court has also explained that, in order to determine whether a creditor has a right to payment giving rise to a claim, courts must look in the first instance to substantive non-bankruptcy law:

> Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code. The "basic federal rule" in bankruptcy is that state law governs the substance of claims, Congress having "generally left the determination of property rights in the assets of a bankrupt's estate to state law." "Unless some federal interest requires a different result, there is no reason why [the state] interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."

Raleigh v. Ill. Dep't of Revenue, 530 U.S. 15, 20 (2000) (quoting *Butner v. United States*, 440 U.S. 48, 54-55 (1979); *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161-62 (1946)).

With specific regard to attorneys' fees, the Court long ago concluded that, for purposes of determining whether a creditor holds a claim for its fees arising out of a contract, "[t]he construction of the contract for attorney's fees presents . . . a question of local law." *Security Mortgage Co. v. Powers*, 278 U.S. 149, 154 (1928). Similar to its reasoning in *Raleigh*, the Court acknowledged in *Security Mortgage* that bankruptcy law *might* bar the enforceability of an entitlement to attorneys' fees against the debtor's property in the sense that Congress has the authority to enact such a rule as part of the governing statutory scheme. But the Court also found that bankruptcy law does *not* actually present any such bar: "The character of the obligation to pay attorney's fees presents no obstacle to enforcing it in bankruptcy, either as a provable claim or by way of a lien upon specific property." *Id.*

More recently, in *Cohen*, the Court considered the scope of the term "debt" for purposes of the Code's discharge provisions, and whether the term "debt" encompassed a debtor's state-law liability for treble damages, costs, and attorneys' fees. In that case, a state official determined that the debtor had improperly charged excessive rents to his tenants and ordered him to refund the overage. The debtor then filed for bankruptcy seeking to discharge

the refund obligation. The tenants filed an adversary proceeding in the bankruptcy court, asserting that the debt was non-dischargeable, and that the debtor should be liable to them for treble damages, costs, and attorneys' fees under state law. The Court agreed, concluding that the obligations were all valid "debts" for bankruptcy purposes, 523 U.S. at 223, and, hence, claims. 11 U.S.C. § 101(12).

The holding in *Cohen* demonstrates that a creditor's claim for attorneys' fees properly constitutes an allowable "claim" in a debtor's bankruptcy case. Consistent with this holding, many courts of appeals have long adhered to the rule that a creditor's claim for attorneys' fees constitutes a bankruptcy claim if valid under state law. *E.g.*, *Alport v. Ritter (In re Alport)*, 144 F.3d 1163, 1168 (8th Cir. 1998); *Davidson v. Davidson (In re Davidson)*, 947 F.2d 1294, 1297-98 (5th Cir. 1991); *Transouth Fin. Corp. of Fla. v. Johnson*, 931 F.2d 1505, 1507 (11th Cir. 1991); *Jordan v. Southeast Nat'l Bank (In re Jordan)*, 927 F.2d 221, 227 (5th Cir. 1991) ("creditors are entitled to recover attorney's fees in bankruptcy claims if they have a contractual right to them valid under state law"); *Martin v. Bank of Germantown (In re Martin)*, 761 F.2d 1163, 1168 (6th Cir. 1985); *Worthen Bank & Trust, N.A. v. Morris*, 602 F.2d 826, 828-29 (8th Cir. 1979).

Considering the specifics of Travelers' contractual right to recover its attorneys' fees in this case in conjunction with the Code's definition of the term "claim," Travelers' entitlement to its fees is plainly a "right to payment" because it is an obligation that is enforceable outside the bankruptcy context under California law. *Cohen*, 523 U.S. at 218. Travelers' right is "unliquidated" because the precise amount has not yet been ascertained. Its right was "contingent" as of the Petition Date in the sense that Travelers had not yet incurred its fees, but is now "fixed" to the extent that Travelers has actually incurred its fees. Travelers' right is also fixed in the sense that its right has existed as an affirmative obligation under the parties' pre-petition Indemnity Agreements since the execution of these contracts. *Stillwater Nat'l Bank & Trust Co. v. Kirtley (In re Solomon)*, 299 B.R. 626, 639 n.55 (B.A.P. 10th Cir. 2003) ("[T]he Debtors unconditionally

guaranteed the . . . debt and there was no evidence that the Bank would forego collection or enforcement from Debtors. In short, the Debtor's liability under the guaranty was not contingent.").

Travelers' right is "matured" because PG&E's obligation to pay the fees has come due, and is "disputed" because PG&E disputes Travelers' entitlement. *In re Moffat*, 107 B.R. 255, 261 (Bankr. C.D. Cal. 1989) (an obligation "matures" when it "becomes due"), *aff'd*, 119 B.R. 201 (B.A.P. 9th Cir. 1990), *aff'd*, 959 F.2d 740 (9th Cir. 1992). Travelers' right is "legal" because it arises out of its contracts, and "unsecured" because Travelers has not taken a lien on any collateral to secure payment of the fees. In sum, Travelers' right to payment of its attorneys' fees is squarely a "claim" for bankruptcy purposes because *each* of the characteristics of its claim fall within the statutory definition.

This Court has made clear that the fact that a contractual obligation to pay attorneys' fees is "contingent" as of the date the debtor commences its bankruptcy case (in the sense that, although the debtor is obligated under a pre-petition contract to pay them, the creditor has not yet incurred the fees) does not remove the obligation from the definition of the term "claim." For example, in *Security Mortgage*, the Court determined that the fact that the creditor's claim for attorneys' fees was "contingent" at the time the debtor commenced its bankruptcy case (meaning that the creditor had a contractual right to collect its attorneys' fees that existed before the debtor filed for bankruptcy, but the creditor had not yet incurred the fees at the time the debtor commenced its case) was no obstacle to the allowance of the claim for fees incurred subsequent to the debtor's bankruptcy filing. 278 U.S. at 155-56.

Following *Security Mortgage*, other courts have also concluded that a creditor may recover its fees where the fees are incurred after the debtor files for bankruptcy, but the creditor's right to the fees arises under a pre-petition contract -- including fees incurred in litigating federal bankruptcy issues. For example, in *In re Martin*, 761 F.2d 1163 (6th Cir. 1985), the debtor executed a loan agreement granting the creditor the right to recover attorneys' fees incurred in collecting the loan. After the debtor filed for bankruptcy relief, the creditor objected to the debtor's

discharge (an issue of bankruptcy law) and sought attorneys' fees in connection with collecting its loan in the bankruptcy court. Following *Security Mortgage*, the Sixth Circuit concluded that the creditor held a valid claim for its fees. *Id.* at 1168.

Similarly, in *Three Sisters Partners, LLC v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843 (4th Cir. 1999), the debtor executed a lease agreement that obligated the debtor to pay the lessor's attorneys' fees in connection with the lessor's pursuit of its rights. After the debtor filed for bankruptcy, the lessor incurred attorneys' fees in connection with its efforts to recover its property and protect its interests under applicable bankruptcy law. Specifically, the lessor incurred fees in moving for relief under various provisions of the Bankruptcy Code and actively participating in the case. After the debtor "assumed" the lease under section 365 of the Code (i.e., agreed to be bound by its terms), the lessor sought recovery of its fees. The bankruptcy court denied recovery, determining that the lessor could not recover fees for taking actions to protect its interests in the bankruptcy court or litigating bankruptcy issues. The Fourth Circuit reversed, holding that "the bankruptcy court erred to the extent that it applied a bright-line test precluding the award of fees for actions primarily involving issues of bankruptcy law." *Id.* at 852.

As these cases well illustrate, Travelers' state-law, contractual right to recover its attorneys' fees from PG&E constitutes a "claim" for bankruptcy purposes within the plain meaning of section 101(5). In turn, because no provision of the Bankruptcy Code *disallows* Travelers' claim, the courts below erred in refusing to allow it.

2. Travelers' claim must be allowed under section 502 of the Bankruptcy Code.

Pursuant to section 502(a) of the Bankruptcy Code, "[a] claim . . . is deemed allowed, unless a party in interest . . . objects." 11 U.S.C. § 502(a). PG&E objected to Travelers' claim for its fees. Pursuant to section 502(b), "if [an] objection to a claim is made, the court, after notice and a hearing, *shall* determine the amount of such claim in lawful currency of the United States . . . and *shall*

allow such claim in such amount, except to the extent that [one of several enumerated statutory grounds for disallowance of a claim is present]." 11 U.S.C. § 102(b) (emphasis supplied).

It is clear that none of the express statutory grounds for disallowance set forth in section 502(b) direct disallowance of a claim for attorneys' fees because the fees were incurred in adjudicating bankruptcy issues. On the contrary, as the Court explained long ago in *Security Mortgage*, Congress has elected *not* to prohibit the recovery in bankruptcy of an unsecured claim for attorneys' fees that is valid under state law. 278 U.S. at 149. Indeed, the only statutory restriction on claims for attorneys' fees appearing in section 502 is the provision of section 502(a)(4) that limits a pre-petition claim "for services of an . . . attorney of the debtor" to "the reasonable value of such services." 11 U.S.C. § 502(a)(4).

As a general rule, when Congress intends to create an exception to the express provisions of the Bankruptcy Code, it does so expressly. *See F.C.C. v. NextWave Personal Commc'ns, Inc.*, 537 U.S. 293, 302 (2003) ("where Congress has intended to provide . . . exceptions to provisions of the Bankruptcy Code, it has done so clearly and expressly"); *Ohio v. Kovacs*, 469 U.S. 274, 279 (1985). If Congress had intended to create an exception to the allowance of claims for attorneys' fees for those arising from the litigation of bankruptcy issues, it could easily have done so. Conversely, that Congress did not create such an exception demonstrates only that Congress intended no such exception to exist, particularly where Congress created express exceptions for certain kinds of attorneys' fees -- those of the debtor's attorney under section 502(a)(4). *NextWave*, 537 U.S. at 302; *Toibb v. Radloff*, 501 U.S. 157, 161 (1991) (refusing to infer exception to section 109 of the Bankruptcy Code, stating, "Congress knew how to restrict recourse to the avenues of bankruptcy relief"); *Kovacs*, 469 U.S. at 279.

Because none of the enumerated statutory exceptions to allowance apply, the plain language of section 502(b) -- which uses the mandatory term "shall" -- requires the allowance of Travelers' claim for its fees. *Miller v. French*, 530 U.S. 327, 337-

38 (2000) (stating that the term "shall" should not be construed as permissive because doing so would undercut the mandatory command of the statute); *Anderson v. Yungkau*, 329 U.S. 482, 485 (1947) (construing the terms "may" and "shall" in their "usual sense -- the one act being permissive, the other mandatory"). The disposition required by the text is neither absurd nor demonstrably contrary to Congress's purpose in enacting the statute, and the lower courts in this case were not at liberty to disallow Travelers' claim in a manner at odds with the governing statutory scheme.

B. The *Fobian* Rule Cannot Be Justified On Grounds Of Pre-Emption Or As A Legitimate Invention Of Federal Common Law.

The *Fobian* rule categorically denies the validity of any contractual allocation of attorneys' fees arising from the litigation of bankruptcy issues, absent express authorization by federal law. Although the bases of the *Fobian* rule are obscure, it is clear that the rule is untethered to any provision of the Bankruptcy Code and exists purely as a matter of general federal common law.

In *Fobian*, the debtors (farmers) defaulted on their mortgage debt to a secured creditor and filed for bankruptcy relief. As part of the bankruptcy proceeding, the creditor sought to protect and defend its rights under sections 506 and 1225 of the Bankruptcy Code (governing the treatment of the creditor's secured claim in the debtors' chapter 12 case). The creditor incurred attorneys' fees pursuing its rights under these provisions and claimed that it was entitled to its fees under the terms of its pre-petition loan agreement. Observing that the proper application of sections 506 and 1225 are matters of federal law, the Ninth Circuit concluded that any right to attorneys' fees incurred in connection with litigating the proper application of these provisions must also be a matter of federal law. The court stated: "[W]here the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law, attorneys' fees will not be awarded absent bad faith or harassment by the losing party." *Fobian*, 951 F.2d at 1153.

In support of its decision, the Ninth Circuit cited three cases: *Johnson v. Righetti (In re Johnson)*, 756 F.2d 738, 741-42 (9th Cir.

1985); *Collingwood Grain, Inc. v. Coast Trading Co. (In re Coast Trading Co.)*, 744 F.2d 686, 693 (9th Cir. 1984); and *Grove v. Fulwiler (In re Fulwiler)*, 624 F.2d 908, 910 (9th Cir. 1980). The Ninth Circuit appears to have derived its *Fobian* rule from dicta in *Johnson*. *See* 756 F.2d at 741 (stating that "because federal [bankruptcy] law governs the disposition of this [bankruptcy question], it should also govern the disposition of the attorney's fee issue in this case" and concluding that, because no federal statute authorized the recovery of attorneys' fees, the fees were not recoverable). In adopting its rule, the court did not examine in any depth the text, structure, history, or policies of the Bankruptcy Code. Nor did it cite this Court's precedents regarding whether a right to attorneys' fees may constitute a claim for bankruptcy purposes. Nor did the court perform any apparent pre-emption analysis. Instead, the court simply announced its standard as a matter of general federal common law -- that contractual rights to attorneys' fees are invalid if the fees arise from the litigation of federal issues unless federal law authorizes the contractual arrangement. In the process, the court essentially federalized the law of contractual allocations of attorneys' fees where litigation over bankruptcy issues is involved.

Wholly apart from the fact that the Ninth Circuit's *Fobian* rule is contrary to the text and structure of the Bankruptcy Code, and likewise this Court's precedents for determining whether a right to attorneys' fees properly constitutes a claim for bankruptcy purposes, the rule is also contrary to this Court's pre-emption standards, as well as those governing the creation of federal common law. Tested under these standards, the Ninth Circuit's rule also fails.

1. There are no grounds for pre-emption in this case.

The Supremacy Clause of the Constitution provides that the laws of the United States "shall be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. CONST. art. VI, cl. 2. As far back as *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), it has been settled that state laws in conflict with federal law are without effect. *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992)

(citing *M'Culloch*). At the same time, any pre-emption analysis under the Supremacy Clause "start[s] with the assumption that the historic police powers of the States [are] not to be superseded by . . . [a] Federal Act unless that [is] the clear and manifest purpose of Congress." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947); *see Cipollone*, 505 U.S. at 516 (citing *Rice*). The Court has reiterated time and again that "[t]he purpose of Congress is the ultimate touchstone of pre-emption analysis." *Cipollone*, 505 U.S. at 516 (internal quotations omitted) (citing *Malone v. White Motor Corp.*, 435 U.S. 497, 504 (1978)); *see also Retail Clerks Int'l Ass'n v. Schermerhorn*, 375 U.S. 96, 103 (1963).

Congressional intent to pre-empt may be found in the express language of the federal statute in question, or may be implied from the structure and purpose of the statutory scheme. *Cipollone*, 505 U.S. at 516 (citing *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977)); *see Almendarez-Torres v. United States*, 523 U.S. 224, 228 (1998) (in determining congressional purpose "we look to the statute's language, structure, subject matter, context, and history -- factors that typically help courts determine a statute's objectives and thereby illuminate its text"); *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 486 (1996) ("Congress' intent, of course, primarily is discerned from the language of the pre-emption statute and the 'statutory framework' surrounding it. Also relevant, however, is the 'structure and purpose of the statute as a whole.") (internal citations omitted). On the question of express pre-emption, the Court has stated: "When Congress has considered the issue of pre-emption and has included in the enacted legislation a provision explicitly addressing that issue, and when that provision provides a 'reliable indicium of congressional intent with respect to state authority,' 'there is no need to infer congressional intent to pre-empt state laws from the substantive provisions' of the legislation." *Cipollone*, 505 U.S. at 517 (citing *California Fed. Savings & Loan*

Ass'n v. Guerra, 479 U.S. 272, 282 (1987), and *Malone*, 435 U.S. at 505).[7]

Alternatively, where there is no "express congressional command," the Court has found implicitly that "state law is pre-empted if that law actually conflicts with federal law, or if federal law so thoroughly occupies a legislative field as to make reasonable the inference that Congress left no room for the States to supplement it." *Cipollone*, 505 U.S. at 516 (internal quotations omitted) (citing *Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n*, 461 U.S. 190, 204 (1983), and *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 153 (1982)); *see also English v. General Elec. Co.*, 496 U.S. 72, 79 (1990) (discussing implied pre-emption); *Butner*, 440 U.S. at 54 n.9 & 55 ("[S]tate laws are . . . suspended only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress . . . . Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."); *Stellwagen v. Clum*, 245 U.S. 605, 613 (1918) (state laws are suspended by bankruptcy only to the extent of an actual conflict with bankruptcy policy).

In determining whether express or implied pre-emption is present, there is a presumption that Congress does not undertake lightly to pre-empt state law, particularly in areas that have traditionally been subject to state regulation:

> [B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action. In all pre-

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[7] Where express pre-emption is present, a conflict analysis may still be necessary to the extent a state statute is not encompassed within the scope of express pre-emption, but conflicts with a federal statute. *Freightliner Corp. v. Myrick*, 514 U.S. 280, 288-89 (1995) ("Our subsequent decisions have not read *Cipollone* to obviate the need for analysis of an individual statute's pre-emptive effects.").

> emption cases, and particularly in those in which Congress has 'legislated . . . in a field which the States have traditionally occupied,' we 'start with the assumption that the historic police powers of the States were not to be superceded by the Federal Act unless that was the clear and manifest purpose of Congress.'

Medtronic, 518 U.S. at 485 (internal citation omitted).

Moreover, in cases between private parties involving contractual rights governed generally by state law, the relevant question is whether the federal statute pre-empts the particular contractual rights at issue. For example the Court held in *Cipollone* that the plaintiff's state law contract claim for breach of express warranty was not pre-empted by the Public Health Smoking Act, which pre-empted generally any requirement "imposed under State law" concerning the regulation of tobacco products. 505 U.S. at 515, 526; *see Am. Airlines, Inc. v. Wolens*, 513 U.S. 219 (1995) (holding that Airline Deregulation Act pre-empted claims based on Illinois Consumer Fraud and Deceptive Business Practices Act, but did not pre-empt state law breach of contract action alleging that airline had violated agreement which it had entered into with its passengers). In *Cipollone*, the Court observed that the contractual obligations of the parties were not requirements "imposed under State law," but instead existed by virtue of the parties' private contractual relationship. *Id.* at 526 n.24. In this case, nothing in the Bankruptcy Code even remotely purports to expressly or impliedly pre-empt state law on the question of the general validity of a party's contractual obligation to pay attorneys' fees.

The Bankruptcy Code provides a framework under which (1) creditors may obtain satisfaction (at least in part) of their pre-petition rights to payment to the extent of funds available to satisfy them; (2) insolvent debtors may obtain the discharge of their debts; and (3) insolvent but viable businesses may be rehabilitated. *E.g.*, *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984) (observing the bankruptcy reorganization policy of permitting the "successful rehabilitation of debtors"); *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) ("one of the prime purposes of bankruptcy law has been to

bring about a ratable distribution among creditors of a bankrupt's assets"); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 588 (1935) ("The discharge of the debtor has come to be an object of no less concern than the distribution of his property."). Within that framework, the Code actually *incorporates* state law in a number of ways.

For example, upon the commencement of a bankruptcy case, the Bankruptcy Code creates a bankruptcy estate consisting of all of the debtor's interests in property. 11 U.S.C. § 541.[8] The Code itself, however, neither creates nor defines the debtor's property rights that comprise the estate. Instead, state law determines the substance of the debtor's property rights. *California. v. Farmers Mkts., Inc. (In re Farmers Mkts., Inc.)*, 792 F.2d 1400, 1402 (9th Cir. 1986) (noting that non-bankruptcy law determines the scope of a debtor's interest in a given asset). Thereafter, the Code prescribes the disposition of the estate in accordance with its own provisions. *E.g.*, 11 U.S.C. §§ 701, 702 (providing for the appointment or election of chapter 7 bankruptcy trustee), 704 (specifying the duties of the trustee, including liquidating property of the estate), 725, 726 (specifying the disposition of the property of the estate). Clearly, the Bankruptcy Code does not expressly or impliedly pre-empt state law on the critical issue of what, in the first instance, constitutes the debtor's property.

Just as the debtor's property rights are determined by state law for purposes of establishing the content of the estate, the existence and amount of the creditors' claims are also determined by state law. Bankruptcy law does not supply its own independent regime

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[8] Section 541 provides that a debtor's estate succeeds to all of the debtor's pre-petition assets, including claims and causes of action. 11 U.S.C. § 541(a)(1); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.9 (1983) ("'The scope of this paragraph [§541(a)(1)] is broad. It includes all kinds of property, including tangible or intangible property, causes of action (see Bankruptcy Act § 70a(6)), and all other forms of property currently specified in section 70a of the Bankruptcy Act.'") (citing H.R. Rep. No. 95-595, at 367 (1977); S. Rep. No. 95-989, at 82 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5868, 6323).

of property rights for purposes of establishing a creditor's claim. Rather, the Code simply incorporates each creditor's state law rights to payment within the definition of a "claim" and prescribes the disposition of the creditor's claim. *E.g.*, 11 U.S.C. §§ 101(5), 502(b) (providing for the allowance of claims generally, and the disallowance of certain claims), 727 (providing for the discharge of debts in chapter 7 cases).

Given that the Bankruptcy Code actually *utilizes* state law to determine whether a creditor has a right to payment and to supply the substance of a creditor's claim, there is no basis to conclude that the Code expressly or impliedly pre-empts state law in determining whether, in the first instance, a creditor has a right to payment. Yet, the Ninth Circuit's *Fobian* rule does just that: It treats the existence of a right to payment involving attorneys' fees as a substantive issue of federal law if the fees arise in connection with litigating bankruptcy issues. But there is no warrant for such pre-emption under the Code and, accordingly, the *Fobian* rule fails under this Court's pre-emption precedents.

2. There is no basis for the creation of a common law rule.

Under the so-called "American rule," it is axiomatic that, in general, a party to litigation in the United States bears its own legal fees. However, the Court has stated repeatedly that "[t]he rule here has long been that attorney's fees are not ordinarily recoverable *in the absence of a statute or enforceable contract providing therefor.*" *Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U.S. 714, 717 (1967) (emphasis supplied); *see also Aleyska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 247 (1975). And like other contract issues, the law governing the enforceability of a contractual provision allocating attorneys' fees is generally applicable state law.

Although this Court has found that contracts governed by state law provide a valid basis for claiming attorneys' fees in bankruptcy, the rule followed by the Ninth Circuit in this case is that "no [attorney's] fees are available under state law for litigation of substantive federal bankruptcy issues in bankruptcy court." *DeRoche*, 434 F.3d at 1192. On its own initiative, the Ninth Circuit has supplanted the state law of contracts that this Court has

long respected, and has replaced it with a new federal common law rule. *Atherton v. FDIC*, 519 U.S. 213, 218 (1997) ("'[F]ederal common law' in the strictest sense, [is] a rule of decision that amounts, not to simply an interpretation of a federal statute or a properly promulgated administrative rule, but, rather, to the judicial 'creation' of a special federal rule of decision.") (citing *Tex. Indus., Inc. v. Radcliff Mats., Inc.*, 451 U.S. 630, 640-43 (1981)).

The creation of new federal common law rules of decision is justified in only the rarest of circumstances:

> The Court has said that "cases in which judicial creation of a special federal rule would be justified . . . are . . . 'few and restricted.'" *O'Melveny & Meyers v. FDIC*, 512 U.S. 79, 87, (1994) (quoting *Wheeldin v. Wheeler*, 373 U.S. 647, 651, 83 (1963)). "Whether latent federal power should be exercised to displace state law is primarily a decision for Congress," not the federal courts. *Wallis v. Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966). Nor does the existence of related federal statutes automatically show that Congress intended courts to create federal common-law rules, for "'Congress acts . . . against the background of the total *corpus juris* of the states . . . .'" *Id.* at 68 (quoting H. Hart & H. Wechsler, The Federal Courts and the Federal System 435 (1953)). Thus, normally, when courts decide to fashion rules of federal common law, "the guiding principle is that a significant conflict between some federal policy or interest and the use of state law . . . must first be specifically shown." 384 U.S., at 68. Indeed, such a "conflict" is normally a "precondition." *O'Melveny, supra*, at 87. *See also United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728 (1979); *Kamen v. Kemper Fin. Services, Inc.*, 500 U.S. 90, 98 (1991).

Atherton, 519 U.S. at 218-19.

In *Atherton*, the Court noted that "[n]o one doubts the power of Congress to legislate rules for deciding cases," but recognized that none of the relevant statutes enacted by Congress actually provided

a rule of decision, which, in that case, involved the applicable standard of care by which a party's conduct would be judged. *Id.* at 219. The Court explained that, in the absence of a federal standard, "we must decide whether the application of state-law standards of care . . . would conflict with, and thereby significantly threaten, a federal policy or interest." Finding no such conflict, the Court allowed the state-law standard to be applied. *Id.*

There is no basis for the Ninth Circuit's common law *Fobian* rule. In considering the adoption of federal common law rules, courts are admonished to remember that "Congress acts . . . against the background of the total *corpus juris* of the states." *Atherton*, 519 U.S. at 218. Courts must also determine that there exists a "significant conflict between some federal policy or interest and the use of state law" because such a showing is a "precondition" to the creation of a federal common law rule of decision. *Id.* at 218-19. No such showing is possible here.

As demonstrated above, the Bankruptcy Code affirmatively employs state law to define the substance of a creditor's "claim." Far from demonstrating any conflict with this use of state law, the Code's text and structure reveal exactly the opposite -- that the successful operation of the Code's claims resolution procedures depends in the first instance on state law to supply the substance of each creditor's claim. There is thus no basis for concluding that federal bankruptcy law supports the creation of a common law rule governing contractual allocations of attorneys' fees.

Moreover, such a common law rule only interferes needlessly with market practices and expectations. Every day, parties enter into contracts allocating the costs of litigation. These contracts include insurance policies, surety bonds, settlements, and indemnity agreements. Just as there is no general federal common law of contract, there is also no general federal common law of contractual loss-allocation applicable in or out of bankruptcy. Rather, in the absence of specific federal pre-emption, contracts allocating the costs of litigation (including attorneys' fees) are governed by state law irrespective of whether the losses arise from a controversy involving issues of state or federal law. *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 83, 87-88 (1994) (reiterating that

"[t]here is no federal general common law" and that there must be a "significant conflict between some federal policy or interest and the use of state law . . . as a precondition for recognition of a federal rule of decision" in order to avoid becoming "awash in 'federal common-law' rules") (citations omitted).

For example, it is routine for parties to enter into contractual settlement agreements allocating the costs of a particular lawsuit. Except to the extent specifically pre-empted by federal law, the enforceability of such an agreement (like any other contract) is obviously a question of state law, even though the settled controversy involves federal issues. Likewise, because the definition of a "claim" in bankruptcy includes virtually every kind of contractual obligation, a party's obligation under a settlement agreement involving litigation over federal issues may form the proper basis for a claim in bankruptcy.

Surety bonds and policies of insurance allocating particular liabilities also are routine. Except to the extent specifically pre-empted by federal law, the enforceability of these contracts is also purely a question of state law, even though the contract covers liabilities incurred in litigating federal issues or with federal entities. For example, a claim under a fidelity bond by a federal agency is properly governed by applicable state law. *FDIC v. Nat'l Union Fire Ins. Co.*, 205 F.3d 66, 70 (2d Cir. 2000) ("Although the FDIC is a party to this suit, recovery under the bond in this case is determined under principles of New York law.").

Indemnity agreements allocating losses are also commonplace. Except to the extent specifically pre-empted by federal law, the enforceability of a contract of indemnity allocating the costs of litigation is also purely a question of state law, even though the matters that are the subject of the indemnity may involve federal issues. For example, an attorneys' fee provision is enforceable under state law even though the subject matter of the litigation giving rise to the particular fees is one in admiralty. *Port of Stockton v. Western Bulk Carrier KS*, 371 F.3d 1119, 1121 (9th Cir. 2004) (stating in admiralty case that the enforceability of an attorneys' fee provision is a matter of state law).

In other areas, courts routinely honor contractual rights to attorneys' fees without federal statutory authorization in cases involving an underlying adjudication of federal issues. *E.g.*, *Coastal Fuels Mktg., Inc. v. Fla. Express Shipping Co.*, 207 F.3d 1247 (11th Cir. 2000) (maritime law); *Sea-Land Serv., Inc. v. Murrey & Sons Co.*, 824 F.2d 740 (9th Cir. 1987) (same); *United States ex rel. C.J.C., Inc. v. Western States Mech. Contractors, Inc.*, 834 F.2d 1533 (10th Cir. 1987) (Miller Act); *United States ex rel. Noyes v. Kimberly Constr., Inc.*, 43 Fed. Appx. 283 (10th Cir. 2002) (same); *Franklin Fin. v. Resolution Trust Corp.*, 53 F.3d 268 (9th Cir. 1995) (Financial Institutions Reform, Recovery and Enforcement Act); *Resolution Trust Corp. v. Miller*, 67 F.3d 308 (9th Cir. 1995) (unpublished opinion) (Federal Deposit Insurance Corporation Statute).

For example, in *Coastal Fuels*, the Eleventh Circuit reviewed an admiralty case involving damages to a chartered vessel in which the lower court awarded attorneys' fees to the principal prevailing vessel owner. 207 F.3d 1247. In addressing the vessel owner's entitlement to attorneys' fees under federal maritime law, the Eleventh Circuit observed the general rule in admiralty that "[a] party is not entitled to attorney's fees . . . unless fees are statutorily or contractually authorized," but concluded that such fees are authorized because of the specific provision within the bareboat charter agreement allowing for the recovery of attorneys' fees as damages for breach of the charter. *Id.* at 1250-51. Recognizing the same limitation to the recovery of attorneys' fees in federal court, the Ninth Circuit, in *Sea-Land Service*, affirmed a district court's award of attorneys' fees to a prevailing carrier under the Shipping Act because the bill of lading constituted a valid contract between the parties and expressly provided that the shipper was liable for attorneys' fees incurred in the collection of freight changes thereunder. 824 F.2d at 744-45.

Subcontracts allocating liability for attorneys' fees in the context of the Miller Act have been repeatedly honored, despite the fact that the federal statute itself does not provide for such fees. In *Noyes*, the Tenth Circuit found that the district court abused its discretion in halving attorneys fees to a supplier pursuant to a sales

contract that provided for payment of attorneys' fees by the buyer/subcontractor in the event of default. 43 Fed. Appx. 283. In remanding with instructions for the district court to state its reasoning for reducing the fees claimed, the Tenth Circuit explained that the provision of fees in a commercial agreement is "fundamentally different" from statutes and held that "where a contract, as opposed to a statute, provides for attorney's fees, the district court should . . . award fees consistent with their contractual purpose: to give the parties the benefit of their bargain." *Id.* at 288 (citing *United States ex rel. C.J.C., Inc. v. Western States Mech. Contractors, Inc.*, 834 F.2d 1533, 1548 (10th Cir. 1987)). Demonstrated in reverse, the Tenth Circuit held in *C.J.C.* that a subcontractor was not entitled to attorneys' fees in its Miller Act breach of contract action against a contractor because there was no provision in the subcontract providing for payment of fees. 834 F.2d at 1543 ("The Act does not provide attorneys' fees for the prevailing party. Absent a provision in the contract . . ., a Miller Act plaintiff may only recover under one of the federally recognized exceptions to the general principle that each party should bear the costs of its own legal representation.") (internal citation omitted). The Tenth Circuit made clear, however, that "[w]hen the agreement between the contractor and the subcontractor provides for attorneys' fees, the subcontractor may recover from the contractor and its Miller Act surety consistent with the terms of that agreement." *Id.* at 1548.

The Financial Institutions Reform, Recovery and Enforcement Act, a federal receivership and conservator scheme, also recognizes contracts providing for attorneys' fees. In *Franklin Financial*, a receiver was appointed to manage or dispose of the assets of a federally chartered savings and loan association. 53 F.3d 268. The receiver decided to repudiate a lease that it determined to be burdensome. *Id.* at 269-70. Subsequent litigation arose between the receiver and the association over the repudiation. The receiver sought recovery of attorneys' fees under the terms of the repudiated lease. The Ninth Circuit recognized that the attorneys' fees provisions in the contract were enforceable under Oregon law and remanded the case to the lower court to

determine the amount of attorneys' fees to be awarded to the receiver. *Id.* at 273. *See* OR. REV. STAT. § 20.096 (2004). ("In any action or suit in which a claim is made based on contract, where such contract specifically provides that attorney fees and costs incurred to enforce the provisions of the contract shall be awarded to one of the parties, the party that prevails on the claim, whether that party is the party specified in the contract or not, shall be entitled to reasonable attorney fees in addition to costs and disbursements."); *see also Resolution Trust Corp. v. Miller*, 67 F.3d 308 (9th Cir. 1995) (unpublished) (honoring attorneys' fees provision of promissory note in litigation involving the Federal Deposit Insurance Corporation Statute, 12 U.S.C. § 1823(e)).

As these and similar decisions demonstrate, a contractual right to attorneys' fees is not rendered invalid simply because the fees are incurred in a federal proceeding involving questions of federal law. Where, as here, no provision of the Bankruptcy Code disallows Travelers' valid contractual, state-law claim for attorneys' fees, no other rule of federal law requires that Travelers' state law rights be abrogated. Accordingly, the decision below must be reversed.

C. The *Fobian* Rule Conflicts With This Court's Precedents Restricting The Ability Of Federal Courts To Prescribe The Categorical Treatment Of Claims In Bankruptcy.

The *Fobian* rule is also wrong because it conflicts irreconcilably with the Court's precedents restricting the ability of federal courts to categorically establish how claims are to be treated under the Bankruptcy Code. *United States v. Noland*, 517 U.S. 535 (1996); *United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213 (1996). In *Noland*, the Sixth Circuit approved the categorical subordination of certain tax penalty claims. The court reasoned that, under principles of equitable subordination, the penalty claim at issue should not be paid on par with other unsecured claims, even though the United States had done nothing inequitable in pursing the relevant penalties (inequitable conduct being a traditional requirement for equitable subordination). This Court reversed, concluding that federal courts do not have the authority to prescribe the categorical treatment of

claims "at the same level at which Congress operated when it made its characteristically general judgment to establish the hierarchy of claims in the first place." *Noland*, 517 U.S. at 540; *see also CF&I*, 518 U.S. at 228-29.

Applying the Court's reasoning in *Noland* and *CF&I* to the treatment of claims for attorneys' fees, the *Fobian* rule is similarly "inappropriately categorical." *Noland*, 517 U.S. at 543. In essence, *Fobian* and its progeny establish that *all* claims for attorneys' fees arising from indemnity agreements must be categorically disallowed under the Bankruptcy Code if the fees relate to the litigation of bankruptcy issues. Policy judgments of this kind, however, are properly reserved for Congress, not the courts. Because Congress has not prescribed such a categorical exclusion in the Bankruptcy Code, the *Fobian* analysis is unsound. *See also BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994) (proscribing "policy determinations that the Bankruptcy Code gives [the court] no authority to make").

D. The *Fobian* Rule Conflicts With The Historical Treatment Of Claims For Attorneys' Fees In Bankruptcy.

This Court has stated that, "[w]hen Congress amends the bankruptcy laws, it does not write on a clean slate." *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (internal quotation marks and citation omitted). Similarly, the Court "'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'" *Cohen*, 523 U.S. at 221 (quoting *Davenport*, 495 U.S. at 563); *see CF&I*, 518 U.S. at 221 (1996); *Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 500-02 (1986); *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 218 (1936) ("To fix the meaning of these provisions [of the Bankruptcy Act] there is need to keep in view the background of their history.").

Following this Court's decision in *Security Mortgage Co. v. Powers*, 278 U.S. 149 (1928), courts applying the former Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1979) (the predecessor to the current Bankruptcy Code) allowed claims for attorneys' fees if the creditor holding the claim was entitled to the fees under state law. There is no indication that Congress intended

to abrogate this practice in enacting the provisions of the Code. Accordingly, the Court should conclude that it endures.

The former Bankruptcy Act did not define the term "claim" in its the general definitional provisions. The Act did, however, define the term "debt" as "any debt, demand, or claim provable in bankruptcy." 11 U.S.C. § 1(14) (repealed 1979). In turn, section 63 of the Act provided that "[d]ebts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, . . . absolutely owing at the time of the filing of the petition . . ., whether then payable or not . . . [and] (8) contingent debts and contingent contractual liabilities." 11 U.S.C. § 103 (repealed 1979).[9] Section 57 of the Act provided additional requirements of proof in order for a claim to be allowed. 11 U.S.C. § 93 (repealed 1979); *see* 3 COLLIER ON BANKRUPTCY ¶ 57, at 101-102 (14th ed. 1977) (discussing section 57 and former Bankruptcy Rule 301 implementing section 57); 3A COLLIER ON BANKRUPTCY ¶ 63.15[3], at 1775-78 (14th ed. 1975) (discussing difference between the concepts of "provablility" and "allowability").

Following this Court's decision in *Security Mortgage*, courts routinely allowed claims for attorneys' fees if the creditor was entitled to the fees under applicable state law. *See Mills v. East Side Investors (In re East Side Investors)*, 702 F.2d 214, 215 (11th Cir. 1983) ("The filing of a petition for reorganization under Chapter XII of the Bankruptcy Act does not diminish the debtor's obligation for attorney fees if vested when the petition is filed."); *James Talcott, Inc. v. Wharton (In re Continental Vending Mach.*

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[9] As originally enacted, section 63 of the Act did not provide for the provability and allowance of claims that were contingent as of the petition date. 3A COLLIER ON BANKRUPTCY ¶ 63.15[3] at 1853 (14th ed. 1975). In 1938, however, the Bankruptcy Act was amended to include subsection (8), which allowed claims that were contingent to be "proved." 11 U.S.C. § 103(8); *see* 3A COLLIER ON BANKRUPTCY ¶ 63.15[3] at 1852-53 (14th ed. 1975) (discussing 1938 amendment and inclusion of subsection (8)).

Corp.), 543 F.2d 986, 992-93 (2d Cir. 1976) (allowing recovery of fees pursuant to state law); *In re Ferro Contracting Co.*, 380 F.2d 116, 120 (3d Cir. 1967) (allowing recovery on claim for contractual allocation of attorneys' fees based on state law); *Hartman v. Utley*, 335 F.2d 558, 559 (9th Cir. 1964) (following *Security Mortgage* and stating that "[t]here is nothing in the character of an agreement to pay attorneys' fees that renders it suspect in bankruptcy. If the agreement is valid under local law, a claim based upon it is provable in bankruptcy"); *Mesard v. Ullmann (In re Am. Motor Prods.)*, 98 F.2d 774, 775 (2d Cir. 1938) (applying *Security Mortgage* analysis in allowing fees and stating that "[t]here are no general equitable principles under which, in the absence of fraud or usury, a court may substitute its own ideas of what would be just and fair to nullify the agreement of the parties to a contract"); *In re Schafer's Bakeries*, 155 F. Supp. 902, 907 (E.D. Mich. 1957) (stating that "the validity and enforceability of these agreements for payment of attorney fees and expenses must be determined under applicable state law" and applying *Security Mortgage* analysis); *see also* Gadsden and Yamasaki, *Recovery of Attorney Fees as an Unsecured Claim*, 114 BANKING L.J. 594, 598-600 (1997) ("In cases decided under the Bankruptcy Act, the higher courts consistently held that attorney fees were allowable even as unsecured claims in bankruptcy."); *LeLaurin v. Frost Nat'l Bank*, 391 F.2d 687 (5th Cir. 1968) (holding that amount allowed by referee as reasonable attorneys' fee was binding as between holder and trustee in bankruptcy).

Similarly, following *Security Mortgage*, courts allowed claims for attorneys' fees incurred in litigating federal bankruptcy issues. For example, in *United Merchants & Mfrs. Inc. v. Equitable Life Assurance Soc'y (In re United Merchants & Mfrs., Inc.)*, 674 F.2d 134 (2nd Cir. 1982), the debtor executed agreements with two creditors that contained provisions obligating the debtor to pay the creditors' costs of collection, including attorneys' fees. After the debtor filed for bankruptcy, the creditors incurred attorneys' fees both before the debtor filed for bankruptcy and subsequently during the bankruptcy proceedings in connection with pursuing and protecting their rights in the bankruptcy court (including the

litigation of bankruptcy issues). The bankruptcy court disallowed the fees incurred in protecting their rights in the bankruptcy proceedings. Following *Security Mortgage*, the Second Circuit reversed, concluding generally that a claim for attorneys' fees is allowable in bankruptcy, and specifically that the portion of the fees that the creditors incurred in pursuing and protecting their rights in the bankruptcy court were also allowable. *Id.* at 137-139; *see also In re Ferro Contracting Co.*, 380 F.2d at 120 ("[I]t is not necessary to determine whether these services were rendered prior to bankruptcy. This is so because no matter when or how rendered, such fees if reasonable and if permitted by local law are assertable according to the contractual stipulation of the parties.").

When Congress enacted the Bankruptcy Code in 1978, it replaced the concept of a "provable debt" with the definition of "claim" appearing in section 101(5). Congress likewise enacted section 502 to provide for the allowance of claims generally, and the disallowance of certain specific claims enumerated in the section. 11 U.S.C. § 502; *see also* 4 COLLIER ON BANKRUPTCY ¶ 502.LH[1], at 502-82.1 (15th ed. rev. 2006). Under the Code, the concept of an allowable "claim" is broader than the concept of a provable debt under former section 63. *See* 2 COLLIER ON BANKRUPTCY ¶ 101.05[1], at 101-38 (15th ed. rev. 2006) ("The Code defines the term 'claim' much more broadly in section 101(5) than under previous law."). Further, the definition of "claim" in section 101(5) leaves untouched the principle that this Court articulated in its decision in *Butner* that state law determines the substance of a creditor's claim. 440 U.S. at 54-55; *see also Vanston*, 329 U.S. at 161-62.

There is simply no reason to conclude that Congress intended to alter the pre-Code practice of allowing claims for attorneys' fees that are valid under state law, including fees incurred in litigating bankruptcy issues. Accordingly, the Court should conclude that this practice endures under the Code.

E. The *Fobian* Rule Conflicts With The Fundamental Bankruptcy Policy of Equality Of Distribution.

The *Fobian* rule is further contrary to the fundamental bankruptcy policy of equality of distribution among creditors,

implemented through the Code's claims-processing provisions. *See Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, ___ U.S. ___, 126 S.Ct. 2105, 2109 (2006) ("the Bankruptcy Code aims, in the main, to secure equal distribution among creditors"); *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) ("one of the prime purposes of bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets"); *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 227 (1930) ("The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate"); *see also Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (noting continued policy of equality of distribution under the Bankruptcy Code). Obviously, to the extent that Travelers is unable to recover anything on its claim for its attorneys' fees, it will not share ratably in the debtor's assets in spite of the otherwise valid nature of its claim.

If Travelers is to be foreclosed from all recovery on its claim, that result should stem from an express provision of the Bankruptcy Code that prescribes the relevant rule of preclusion, not a judge-made rule that is not based on any actual provision of federal bankruptcy law or necessary to its implementation. *Nathanson v. NLRB*, 344 U.S. 25, 29 (1952) ("The theme of the Bankruptcy Act is 'equality of distribution', . . . and if one claimant is to be preferred over others, the purpose should be clear from the statute.") (quoting *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941)). Because no such rule of preclusion properly exists, Travelers is entitled to its ratable share.

F. The *Fobian* Rule Is Impractical.

The *Fobian* analysis is further in error because it compels an impractical standard for claims allowance. Many (if not most) disputes in bankruptcy involve the litigation of both state and federal issues because, whereas claims typically arise under state law, the bankruptcy rules and procedures employed to process them are federal in nature. For example, litigation over the debtor's assumption of a lease under section 365 of the Code, 11 U.S.C. § 365, typically involves not only consideration of state-law issues surrounding the validity and terms of the lease itself, but also consideration of the federal bankruptcy rules of assumption

and rejection set forth in the statute. *In re Stoltz*, 197 F.3d 625, 629-30 (2d Cir. 1999) (in analyzing whether debtor could "assume" lease under section 365, the court relied upon state law, stating: "because property interests are created and defined by state law, federal courts have looked to state law to determine a debtor's interests"). Under *Fobian* and its progeny, a creditor may recover fees incurred in litigating the state law issues, but not those arising under section 365. *E.g.*, *Renfrow*, 232 F.3d at 693-94 (concluding that attorneys' fees incurred in adjudicating certain controversies involving state law issues would be allowed, while attorneys' fees incurred in adjudicating other controversies involving bankruptcy issues would not be, and requiring bankruptcy court to sort this out); *Hashemi*, 104 F.3d at 1126-27 (same); *Baroff*, 105 F.3d at 442-43 (same). Yet, in most instances in bankruptcy cases, it will be nearly impossible to differentiate meaningfully fees incurred in litigating one set of issues from the other because they are typically intertwined. This difficulty presents an obvious and time-consuming administrative burden, effectively undermining the efficiency of bankruptcy proceedings as a whole.

An important goal of bankruptcy law is administrative efficiency. *Hoseman v. Weinschneider*, 322 F.3d 468, 475 (7th Cir. 2003) ("The administration of bankruptcy estates has twin goals of maximization of realization on creditors' claims and of prompt and efficient administration of the estate.") (citation omitted); *Lebovits v. Scheffel (In re Lehal Realty Assocs.)*, 101 F.3d 272, 275 n. 5 (2d Cir. 1996) (noting that Congress's "overall goal" in enacting the Bankruptcy Code was "to create a more efficient procedure for administering bankruptcies"). Because the *Fobian* rule obviously frustrates this goal, it is unsound.

G. Application Of The *Fobian* Rule Leads To Absurd Results.

As applied, the Ninth Circuit's *Fobian* rule also leads to absurd results. This is perhaps best illustrated by the result reached in *DeRoche v. Ariz. Industrial Comm'n*, 434 F.3d 1188 (9th Cir. 2006).

During the course of the DeRoches' bankruptcy proceeding, a creditor, the Arizona Industrial Commission ("Commission"), pursued civil litigation in the bankruptcy court seeking a determination that the Commission's claim against the DeRoches constituted a priority, non-dischargeable debt -- meaning that the obligation should be paid ahead of other claims against the DeRoches, and that the DeRoches should continue to be responsible for the obligation notwithstanding their general discharge in bankruptcy. After the Commission was unsuccessful in the litigation, the DeRoches sought to recover from the Commission, pursuant to Arizona Revised Statutes § 12-348, their attorneys' fees incurred in defending the litigation. Section 12-348 directs that, if the State of Arizona (including one its agencies) is unsuccessful in litigation that it has brought against a party, the party shall recover its attorneys' fees from the State (or agency). *See* ARIZ. REV. STAT. § 12-348.

Applying its *Fobian* rule, the Ninth Circuit held that, notwithstanding section 12-348, the DeRoches could *not* recover their attorneys' fees from the Commission because the priority and non-dischargeability issues litigated in the bankruptcy court were questions of federal bankruptcy law. The Ninth Circuit concluded that state law cannot "create a new federal right of attorney fee recovery in this context," 434 F.3d at 1192, and that, because federal law does not independently validate the state rule, "no [attorneys'] fees are available for litigation of substantive federal bankruptcy issues," *id.* In other words, the Ninth Circuit reached the absurd conclusion that, as a matter of general federal common law, a State cannot direct that its *own* agency may be liable to an opposing party for attorneys' fees incurred in the agency's unsuccessful litigation of federal issues. This result is obviously unsound, and underscores the erroneous nature of the Ninth Circuit's rule.

H. The *Fobian* Rule Is Inequitable.

Finally, foreclosing Travelers from any recovery on its claim would be inequitable. It is certainly true that not all unsecured creditors enjoy the benefit of a contractual right to attorneys' fees. It is also true that disallowing a creditor's contractual right to attorneys' fees may have the effect of equalizing treatment among unsecured creditors by eliminating a contractual right enjoyed by some. But "[e]quality among creditors who have lawfully bargained for different treatment is not equity but its opposite." *Chemical Bank v. Kheel*, 369 F.2d 845, 848 (2d Cir. 1966) (Friendly, J., concurring); *see also United Merch. & Mfrs.*, 674 F.2d at 137 ("We cannot agree that the policy of equitable distribution renders an unsecured creditor's otherwise valid contract claim for collections costs unenforceable in bankruptcy.").

Moreover, as noted, the *Fobian* rule does not bar the allowance of *all* attorneys' fees, just those incurred in litigating bankruptcy issues. So the rule cannot truly be justified as "equalizing" treatment in bankruptcy. In addition, the rule unjustly enriches debtors such as PG&E by permitting them to avoid an obligation that they could not avoid outside the bankruptcy context. *See Butner*, 440 U.S. at 55 (a longstanding policy of bankruptcy law is to prevent a party from receiving "a windfall merely by reason of the happenstance of bankruptcy") (citing *Lewis v. Mfrs. Nat'l Bank*, 364 U.S. 603, 609 (1961)).

Again, if Travelers is to be denied its claim for attorneys' fees, this result should follow from an express provision of the Bankruptcy Code. Because it does not in this case, it is unsound.

CONCLUSION

For the foregoing reasons, the Court should reverse the decision below.

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IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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QUESTIONS PRESENTED

1. The Bankruptcy Code provides that a creditor's claim for contractual postpetition attorneys' fees is allowed "[t]o the extent that" the creditor is oversecured. Travelers is an unsecured creditor. Should its contractual claim for attorneys' fees be disallowed?

2. Travelers issued bonds to assure PG&E's performance of certain obligations. PG&E filed for bankruptcy, but never defaulted on the underlying obligations. Nevertheless, Travelers took steps in the bankruptcy proceeding that, as three courts in a row have held, were unnecessary to preserve its legal rights. Was the Court of Appeals correct in rejecting the claim for attorneys' fees on that basis?

3. Travelers' contract calls for the payment of fees in connection with "enforcing" its contractual rights. Because PG&E never defaulted on its insured obligation there were no contractual rights for Travelers to enforce. Should the disallowance of attorneys' fees be affirmed on the alternative ground that Travelers had no contractual right to attorneys' fees?

CORPORATE DISCLOSURE STATEMENT

Respondent Pacific Gas and Electric Company is a subsidiary of PG&E Corporation. No other publicly traded company owns more than 10% of its stock.

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INTRODUCTION

Petitioner Travelers Casualty & Surety Company of America ("Travelers"), an unsecured creditor, intervened in the bankruptcy proceeding of Respondent Pacific Gas and Electric Company ("PG&E"). PG&E did not owe Travelers any money, and the bankruptcy filing did nothing to undermine Travelers' position under its contracts with PG&E. Yet, Travelers hired a team of lawyers to press a claim—only to concede the claim was not allowed—and to negotiate gratuitous changes to various bankruptcy documents. The Bankruptcy Court, District Court, and Court of Appeals all held that Travelers' conduct did nothing to enhance or protect its rights.

Travelers then presented PG&E with a bill for its lawyers' efforts. It invoked a contractual provision requiring PG&E to reimburse any legal expenses Travelers might incur "enforcing" its contractual rights.

The courts below all agreed that Travelers could not recover its legal fees. They relied mainly on settled Ninth Circuit law—the "*Fobian* rule"—prohibiting the recovery of attorneys' fees for litigation of pure issues of bankruptcy law, while allowing recovery for litigation over state law issues. The central theme in Travelers' brief is that the Bankruptcy Code unequivocally allows an unsecured creditor with a contractual fee-shifting provision to recover attorneys' fees for its postpetition litigation in bankruptcy court. If Travelers' reading of the Code is correct, then every credit card issuer, every lender, and, indeed, most creditors with a written contract can inflate its claims simply by opting to hire expensive lawyers to intervene in, or just monitor, the bankruptcy proceedings.

Travelers is wrong. The Code does not permit unsecured creditors to recover postpetition attorneys' fees. And, as the Court of Appeals pointed out, the Code certainly does not

reward a creditor for pointless and wasteful meddling. Thus, this Court need not decide whether the *Fobian* distinction has any validity. It should affirm, without regard to *Fobian*, on much more straightforward grounds.

RELEVANT PROVISION OF LAW

Beyond the provisions Travelers lists, 11 U.S.C. §§ 506(a) & (b) are also central to this case, and are reproduced in the Appendix to this brief.

STATEMENT OF THE CASE[1]

The facts relevant to PG&E's primary argument can be stated in one sentence: Travelers was an unsecured creditor that sought reimbursement from debtor PG&E for attorneys' fees incurred in intervening in a bankruptcy proceeding. The following details are unimportant unless this Court rejects, or declines to address, PG&E's primary argument.

PG&E Files for Bankruptcy Without Undermining Travelers' Contractual Rights

PG&E filed a voluntary Chapter 11 bankruptcy petition in April 2001. PG&E continued to operate and manage its business as a "debtor in possession." §§ 1107(a), 1108. With the petition, PG&E filed an "Emergency Motion"

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[1] The Brief for Petitioner is cited as "Pet'r Br." The Appendix to the Petition for Writ of Certiorari, the Joint Appendix, and the Supplemental Joint Appendix are cited as "PA," "JA," and "SJA," respectively. The Excerpts of Record in the Court of Appeals are cited as "ER." The Bankruptcy Code is cited by section, without the prefix "11 U.S.C." Unless otherwise specified, citations will be to the Code as it existed at the time of the filing of this bankruptcy case, in 2001, *see* 11 U.S.C. § 101 et seq. (2000), without regard to the recent amendments of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23, which are inapplicable to this case. The Brief of Amici Curiae Profs. Richard Aaron, et al., is cited as "Law Profs."

seeking permission to continue honoring its workers' compensation obligations. That very day, the Bankruptcy Court approved the request. PA 5a; JA 24-25. PG&E has satisfied all of its workers' compensation obligations, and never hinted that it might default on them. PA 5a.

This is a critical fact from the standpoint of Travelers' financial exposure. Travelers had issued surety bonds assuring PG&E's performance of its obligation to pay workers' compensation benefits. PA 5a. PG&E, in turn, executed indemnification agreements, to indemnify Travelers in the event Travelers was ever called upon to cover a defaulted payment under the surety bonds. PA 5a; SJA 3-4; JA 113-14. But, as the courts below all recognized and Travelers stipulated, Travelers never "had to assume any liability pursuant to the bonds" because "PG&E has not defaulted on its workers' compensation obligations." PA 5a.

Travelers Files a Claim, But Stipulates It Is Not Allowed

Nevertheless, Travelers filed a claim against PG&E in the bankruptcy proceeding. SJA 1. This claim (referred to as the "Original Claim") did not assert that PG&E owed Travelers any money. PA 5a. Rather, the claim was based upon the contingency that PG&E *might* some day default on its workers' compensation obligations, and if it did, Travelers *could* be liable to pay the workers. *Id.* If Travelers ever did make those payments, it would have two rights. First, Travelers would have a reimbursement right—the right to demand that PG&E reimburse it for the outlay. *Id.* Second, it would have a subrogation right—the right to stand in the shoes of any injured employees whose payments it covered and assert their claims against PG&E. *Id.*

PG&E objected to the claim. Contrary to Travelers' repeated assertions, this objection did not "commence[] litigation" against Travelers, and could not have "extinguished or impaired" any of Travelers' contractual

rights. *E.g.*, Pet'r Br. at 16; *id.* at 1, 17, 22; *see Travelers Cas. & Sur. Co. v. PG&E Corp.*, No. C-05-0594, 2005 WL 1039080 at *2-*3 (N.D. Cal. May 4, 2005) (rejecting the same assertion, on the same facts, in a parallel case Travelers brought against PG&E's parent company). PG&E did not request any relief other than that the Bankruptcy Court "disallow" these claims, JA 80—in other words, that the court rule that these claims could not be a basis for any recovery of money *in the bankruptcy proceeding*. *See* § 502(b). As to Travelers' reimbursement claim, PG&E pointed out that the Code disallowed any such claim unless and until PG&E defaulted on its underlying obligations. *See* § 502(e)(1)(B). Otherwise, PG&E would be subject to multiple liability to the primary obligee (here, the injured worker) and the surety (Travelers) for the same debt. As to Travelers' contingent subrogation rights, PG&E observed that they are not valid claims in a bankruptcy proceeding, because a subrogation right is not a "right to payment," § 101(5)(A), and, in any event, the right is automatically preserved by operation of the Bankruptcy Code. *See* § 509(a). At this point, there is no dispute that PG&E was correct that neither the reimbursement nor the subrogation claim was allowable. JA 137 (Travelers admits "that our contingent reimbursement rights were subject to disallowance"); Pet'r Br. at 11 n.6, 14 (acknowledging that subrogation rights are not valid claims).

Nevertheless, Travelers paid its legal team $77,000 to draft a 45-page brief arguing that its claims were allowable. JA 120; FR 288-91. Before the Bankruptcy Court could resolve the issue, Travelers conceded otherwise. Travelers stipulated that the reimbursement claim "is hereby disallowed pursuant to Section 502(e)(1)(B) of the Bankruptcy Code," just as PG&E said, because "Travelers has not been called upon to satisfy any of the obligations assured by, or to make any payment with respect to, any of

its Surety Bonds or the Indemnity Agreements." JA 107. As to the subrogation rights, Travelers agreed to the disallowance of its claim, subject to its ability to assert certain potential subrogation rights in the future, and PG&E's ability to object to them: "[N]othing [in the Stipulation] shall prejudice or impair Travelers' subrogation rights under applicable law, or the Debtor's right to object to Travelers' asserted subrogation rights." JA 108. As the Bankruptcy Court observed, this provision did not reserve for either party a benefit that it would not have had anyway by operation of law. JA 128-30. The whole exercise was the litigation equivalent of running on a treadmill while tearing up $100 bills.

The Stipulation also acknowledged that Travelers was free to assert a claim for reimbursement of the attorneys' fees it incurred under the indemnity agreements that were the basis for the Original Claim. JA 108-09. That, too, was an empty assurance, for the parties also agreed that PG&E would be free to object to any such claim. *Id.* Based on this Stipulation, the Bankruptcy Court disallowed Travelers' Original Claim. JA 110.

The Reorganization Plans All Preserve PG&E's Workers' Compensation Obligations

In any Chapter 11 bankruptcy, the documents that shape subsequent duties and obligations are the plan of reorganization (as confirmed by the bankruptcy court) and the related disclosure statement. There is no dispute that every iteration of PG&E's plan and disclosure statement undertook that PG&E would continue to comply fully with all its workers' compensation obligations. JA 28, 60-62. No proposed plan or disclosure statement purported to limit or modify any of PG&E's obligations or Travelers' rights.

Nevertheless, Travelers demanded additional assurances. The parties negotiated what is often called "comfort

language"—superfluous, but innocuous, edits that soothe the creditor without conveying any real legal benefit. First, Travelers insisted on inserting language to underscore what the plan already said, that PG&E would continue to honor its workers' compensation obligations. JA 54, 64. Second, Travelers bargained for language to confirm, again, what was already true as a matter of law, *see* Pet'r Br. at 11 n.6, that nothing in the plan would affect the subrogation rights of any surety of workers' compensation claims. JA 54-56, 62-66. Travelers has never asserted that, without these verbal placebos, the plan could be read to cut off Travelers' potential reimbursement or subrogation rights, but actually admitted otherwise. JA 29-34, 128.[2]

Whenever such comfort language was inserted into any iteration of the plan or disclosure statement, it was coupled with a companion clause reserving PG&E's converse right to object to asserted subrogation rights. *See, e.g.*, JA 54 ("Nothing herein shall affect . . . the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of any such subrogation rights."). While Travelers now asserts that PG&E snuck in this clause later, "unilaterally" modifying the language the two had negotiated, Pet'r Br. at 14; *see id.* at 15-16, the truth is that every iteration of the plan Travelers cites had the same clause—as did the above-quoted Stipulation, itself. JA 54, 108. The final plan, which the Bankruptcy Court ultimately confirmed in 2003, included both the comfort language and the supposedly offensive

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[2] Contrary to Travelers' assertion, the Bankruptcy Court did not find the disclosure statement "inadequa[te]" and did not "require[] PG&E to" change it. Pet'r Br. at 13. As is evident from the transcript pages Travelers cites, and its own account of the negotiations, *see id.* at 14, the court was simply helping the parties negotiate a consensual resolution. *See* JA 40-41, 43-45, 48-49. That is why the court later concluded that Travelers did not prevail in any of its arguments, PA 21a, 23a, as every other court below agreed, PA 2a, 18-19a.

reservation of PG&E's right to oppose subrogation claims. JA 54, 57.

Travelers Seeks Attorneys' Fees for Its Meritless Litigation and Superfluous Comfort Provisions

Travelers filed an Amended Claim, demanding that PG&E cover the legal fees and other expenses Travelers incurred in connection with its activities in the bankruptcy proceeding. SJA 18. The bill came to $167,000. SJA 20-21. The Amended Claim for postpetition attorneys' fees was not premised on any right under the Bankruptcy Code, which does not grant attorneys' fees to an unsecured creditor, except for efforts directed to the benefit of all creditors. *See* § 503(b)(3), (4). Rather, Travelers sought fees as a "claim" in its own right, flowing from a provision of its indemnity agreements with PG&E. The agreements specified that PG&E would be obliged to pay attorneys' fees incurred in "recovering or attempting to recover any salvage in connection [with the surety bonds] or enforcing by litigation or otherwise any of the [indemnification] agreements." SJA 9, 13; *see* Pet'r Br. at 7 (quoting the provision more fully).

PG&E objected to Travelers' attorneys' fees claim on several grounds. Three of them, which PG&E raised at every level, are especially relevant here. The first was an issue of contract interpretation: Travelers had no right to attorneys' fees under the indemnity agreement, because its contingent claim and subsequent negotiations were not part of an action brought on account of the bond, let alone one directed at "enforcing . . . any of the [indemnification] agreements." SJA 13. Second, even if a creditor generally could claim attorneys' fees for its activities in a bankruptcy proceeding, Travelers could not collect fees for its meritless and wasteful activities in this proceeding. Third, PG&E invoked a long line of Ninth Circuit precedents—most notably *Fobian v. W. Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991)—which precluded a creditor

from collecting attorneys' fees incurred with respect to purely bankruptcy law matters, as opposed to state law matters such as the terms or enforceability of a contract.

The Bankruptcy Court and District Court Reject Travelers' Demand for Attorneys' Fees

The Bankruptcy Court disallowed the claim for attorneys' fees. PA 20a-21a, 23a-25a. The court focused mainly on the *Fobian* rule, for the rule was binding authority, and it was clear that all of the attorneys' fees Travelers sought were incurred in litigating pure issues of federal bankruptcy law. PA 24a; JA 130-31, 133, 141. But the Bankruptcy Court also made observations bearing on PG&E's other two grounds. The court observed that Travelers had no basis for filing the Original Claim in the first place as a matter of federal bankruptcy law. JA 133 ("[Travelers] didn't have to file a Proof of Claim .... [Travelers] had no claim to file."). The Bankruptcy Court also found that neither PG&E's objections to the Original Claim nor PG&E's reorganization plans did anything to threaten Travelers' rights. JA 133-34, 139, 141-43.

On appeal to the District Court, PG&E once again asserted all three grounds for affirmance. PA 4a; JA 20. The District Court affirmed. PA 19a. It, too, focused mainly on the *Fobian* rule. PA 17a. But it, too, made findings supporting PG&E's other arguments, noting, for example, that "the measures employed by Travelers cannot be considered 'an action on the contract[s]' or bonds." *Id.*

The Court of Appeals Affirms, Citing Especially Unsympathetic Facts

The Court of Appeals affirmed. PA 1a. Beyond the *Fobian* analysis, two points were especially relevant to its holding. First, the court held that "[n]othing in the federal bankruptcy proceedings required Travelers to satisfy any of the obligations assured by, or to make any payments with

respect to, any of its surety bonds or indemnity agreement with [PG&E]." PA 2a. Second, "Travelers did not prevail on any claim it asserted in the bankruptcy proceedings." *Id.* The Court of Appeals underscored the dangers of awarding attorneys' fees when these two elements converged:

> [I]f unimpaired, non-prevailing creditors were authorized to obtain an attorney fee award in bankruptcy for inquiring about the status of unimpaired inchoate and contingent claims, the system would likely be overwhelmed by fee applications, with no funds available for disbursement to impaired creditors or debtor reorganization.

PA 3a.

Although the Court of Appeals did not dispose of the question of contract interpretation, like the Bankruptcy Court and the District Court before it, the court did make observations bearing on the issue. It pointed out, for example, that "Travelers' objection to the reorganization plan . . . claimed only that the debtor failed to provide 'adequate information' about the reorganization plan," PA 2a, a far cry from "enforcing" its contractual right.

SUMMARY OF ARGUMENT

This Court need not decide whether the *Fobian* distinction is ever correct. For three reasons, Travelers is not entitled to its attorneys' fees, without regard to *Fobian*: (1) unsecured creditors are not entitled to postpetition attorneys' fees; (2) even if they were, Travelers would not be entitled to collect fees because its activities were not reasonably necessary to protect its rights; and (3) Travelers did not, in any event, have any right to attorneys' fees, under its contracts, for its interventions here.

No postpetition fees for unsecured creditors. Contrary to Travelers' central argument, unsecured creditors cannot claim attorneys' fees by contract for participating in a

bankruptcy proceeding. That is the majority rule among the lower courts. Section 502(b) of the Code, which governs allowance of claims, directs that a claim is determined "as of the date of the filing of the petition." If one were to focus myopically on this provision alone, it would be unclear whether a claim for postpetition attorneys' fees is allowed—and, if so, whether any such claim would have to be valued at zero.

Any ambiguity, however, is resolved by another Code provision that refers specifically to contractual fees such as attorneys' fees. Section 506(b) provides that such fees are available "[t]o the extent that" a creditor is oversecured (which means that the creditor's collateral is worth more than the amount of the debt it supports). That must mean that attorneys' fees are not allowed to an unsecured creditor (with no collateral). Any other reading would make § 506(b) superfluous, for it would have been pointless to specify in § 506(b) that oversecured creditors could claim contraetual fees, if § 502(b) already gave all creditors—unsecured and secured, alike—an allowable claim for such fees. This Court has confirmed that this is the only way to read § 506(b). *See United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371-75 (1988). No other reading would save § 506(b) from redundancy.

The rule Travelers proposes is antithetical to the rudiments of bankruptcy policy expressed in the Code. First, for centuries, one of the dominant features of bankruptcy law has been a temporal divide between prepetition and postpetition liabilities; allowing unsecured creditors to collect expenses they opted to incur postpetition would breach that divide. Second, ingrained in the Code is the equally venerable bankruptcy principle of equality of distribution among a class of creditors; allowing some creditors within the class to bloat their own claims would flout that principle. Third, the Code preserves the

longstanding rule that unsecured creditors can recover attorneys' fees only when they have benefited the estate. Fourth, endless litigation over fees would deplete the debtor's assets and burden courts, undermining the Code's goals of maximizing realization for all creditors and prompt and efficient administration.

History, too, confirms this reading. For ages, the rule has been that unsecured creditors could not recover postpetition attorneys' fees. This Court did nothing to alter the rule in *Security Mortgage Co. v. Powers*, 278 U.S. 149 (1928), which held only that an *over*secured creditor could recover attorneys' fees under the Bankruptcy Act, for reasons that are inapplicable to unsecured creditors. In the ensuing 50 years—right up to the adoption of the Code—not a single court ever held that an unsecured creditor could recover fees by contract. Any such notion would have been anathema to the Code's drafters. Since the Code does not explicitly overturn this established practice—and the legislative history indicates that no one even suggested a change—Congress is presumed to have left it intact.

This Court should reach this issue of statutory construction, even though it was not addressed below. First, it would have been futile, in light of *Fobian*, to raise the argument. Second, Travelers' brief revolves around the proposition that the Code allows unsecured creditors to collect attorneys' fees, inviting scrutiny of that position. Third, this case also presents a narrower question of statutory construction—which was preserved below and resolved by the Court of Appeals—but that question cannot be resolved without addressing the broader question. Fourth, the lower courts have been irreconcilably split for two decades.

No postpetition fees for unnecessary activities. Travelers was not the average unsecured creditor seeking to collect a debt owed to it, but an officious intermeddler. Its activities did not preserve any rights it did not already have,

and served only to squander estate assets. If § 502(b)'s general allowance provision is to be stretched to contemplate a right to collect contractual attorneys' fees, it must be read to limit recovery to fees that are reasonably necessary. As three courts below all agreed, Travelers' activities were not.

No right under contract language. The premise of this appeal—that Travelers has a contractual right to collect attorneys' fees in connection with its bankruptcy interventions—is false. The contract covers efforts to "enforc[e]" PG&E's obligations, but PG&E never defaulted on its obligations.

ARGUMENT

The question Travelers presents for review is whether Travelers, an unsecured creditor, "may recover [postpetition] attorneys' fees arising under a contract . . . where the issues litigated involve matters of federal bankruptcy law." Pet'r Br. at i. The answer is no—but not because Travelers litigated "matters of federal bankruptcy law." This Court need not address whether the *Fobian* distinction has any validity—whether, for example, there could *ever* be a circumstance under which a creditor could recover postpetition attorneys' fees for litigating issues of state law. Whether or not *Fobian* has any validity in some other case, the answer to the Question Presented is no, for two more straightforward statutory reasons—one broad and the other narrow—and another legal reason based upon the specific contract in this case. We address each in turn.

I. THE BANKRUPTCY CODE DOES NOT ALLOW UNSECURED CREDITORS TO RECOVER POSTPETITION ATTORNEYS' FEES BY CONTRACT.

Travelers' challenge to *Fobian* revolves around a single premise. To quote a point heading encompassing eight

pages of Travelers' brief, its central premise is: "Travelers' Claim For Attorneys' Fees Is Allowable Under The Plain Text Of The Bankruptcy Code." Pet'r Br. at 21. Specifically (to quote another point heading), Travelers' position rests on the view that "Travelers' claim must be allowed under section 502(b) of the Bankruptcy Code," *id.* at 28. Throughout its brief, with metronomic regularity, Travelers repeats, no fewer than a dozen times, that "[n]o provision of the Code even remotely purports to *disallow* Travelers' claim." *Id.* at 22 (emphasis in original).[3]

Travelers' premise is wrong. Travelers is an unsecured creditor. It is in the same boat as any trade creditor, tort claimant, or other creditor that has not negotiated to secure its debt with collateral. Like virtually any credit card company, and innumerable other contractual creditors, Travelers has a contractual provision entitling it to recover its collection costs when the debtor defaults. *See, e.g., Recovering Attorney's Fees and Costs in Bankruptcy Cases*, 19-May Am. Bankr. Inst. J. 32 (2000) ("Most commercial contracts have standard provisions authorizing the collection of such fees and costs . . . ."); *In re Sakowitz, Inc.*, 110 B.R. 268, 271 (Bankr. S.D. Tex. 1989) ("[V]irtually all promissory notes, deeds of trust, and security agreements provide for attorney fees."). Travelers' position is that the Code entitles every such contractual creditor to enhance its share of the bankruptcy recovery vis-à-vis all other unsecured creditors, by inflating its underlying claim (which,

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[3] *See, e.g.*, Pet'r Br. at 2 ("no provision of the Bankruptcy Code disallows the claim"); *id.* at 28 ("[T]he plain language of section 502(b) . . . requires the allowance of Travelers' claim for its fees."); *id.* at 33 ("[N]othing in the Bankruptcy Code even remotely purports to expressly or impliedly pre-empt . . . a party's contractual obligation to pay attorneys' fees."); *see also id.* at 28 (two additional such statements); *id.* at 35, 41, 42, 42-43, 45, 46, 49.

in this case, was zero) with the expenses it incurs in bankruptcy court collecting the debt or just monitoring the proceedings.

That is not what the Code says—as this Court has held in *Timbers*, 484 U.S. at 371-75, which interprets the very same provisions at issue here. *See infra* Point I.A. Allowing one class of unsecured creditors to jockey in this way for a bigger piece of the pie would be inconsistent with the Code's structure and purpose. *See infra* Point I.B. Indeed, in light of the historical backdrop, Travelers' reading would have been anathema to the Code's drafters. *See infra* Point I.C.

That is why most of the courts that have addressed the question have concluded that unsecured creditors generally cannot collect attorneys' fees incurred after the filing of the bankruptcy petition, even if they can point to a contract purporting to allow such fees. *See In re Pride Cos.*, 285 B.R. 366, 372 (Bankr. N.D. Tex. 2002) (cataloging cases and describing this as the view supported by "[t]he majority of published opinions").[4] While some cases have awarded

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[4] *E.g.*, *In re Miller*, 344 B.R. 769, 773 (Bankr. W.D. Va. 2006); *In re Global Indus. Techs., Inc.*, 327 B.R. 230, 239 (Bankr. W.D. Pa. 2005); *In re Hedged-Invs. Assocs.*, 293 B.R. 523, 526 (Bankr. D. Colo. 2003); *Pride*, 285 B.R. at 372; *In re Loewen Group Int'l*, 274 B.R. 427, 444-45 (Bankr. D. Del. 2002); *In re Smith*, 206 B.R. 113, 115 (Bankr. D. Md. 1997); *Chem. Bank v. First Trust of N.Y. Nat'l Ass'n (In re Southeast Banking Corp.)*, 188 B.R. 452, 462-63 (Bankr. S.D. Fla. 1995), *aff'd*, 212 B.R. 682 (S.D. Fla. 1997), *rev'd on other grounds*, 156 F.3d 1114 (11th Cir. 1998); *In re Woodmere Investors, Ltd. P'ship*, 178 B.R. 346, 356 (Bankr. S.D.N.Y. 1995); *In re Barrett*, 136 B.R. 387, 394-95 (Bankr. E.D. Pa. 1992); *In re Saunders*, 130 B.R. 208, 210-11 (Bankr. W.D. Va. 1991); *In re Sakowitz, Inc.*, 110 B.R. 268, 272 (Bankr. S.D. Tex. 1989) ; *see also Adams v. Zimmerman*, 73 F.3d 1164, 1177 (1st Cir. 1996) (citing the rule with approval); *In re Waterman*, 248 B.R. 567, 573 (8th Cir. BAP 2000) (same); *Ins. Co. of N. Am. v. Sullivan*, 333 B.R. 55, 60 (D. Md. 2005) (same); Hon. Burton Lifland, Lawrence Mittman & Rees Morrison, *Bankruptcy Commentary*, 49 Brook. L. Rev. 741, 772-74 (1983) (supporting majority rule).

postpetition attorneys' fees by contract,[5] courts that have addressed the question in the last decade are almost unanimous (19 out of 22) in disallowing recovery of postpetition collection expenses from the bankruptcy estate.

A. The Code's Plain Language Does Not Allow Unsecured Creditors to Claim Postpetition Attorneys' Fees.

Travelers correctly points out that the Code adopts an expansive definition of "claim," encompassing any "right to payment." § 101(5)(A). That definition would seem to cover a "right to payment" of postpetition attorneys' fees, even though attorneys' fees are nowhere mentioned in the definition. But claims are allowed only "subject to any qualifying or contrary provisions of the Bankruptcy Code." *Raleigh v. Ill. Dep't of Revenue*, 530 U.S. 15, 20 (2000).

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[5] *E.g., Liberty Nat'l Bank & Trust Co. of Louisville v. George*, 70 B.R. 312, 317 (W.D. Ky. 1987); *In re Hunter*, 203 B.R. 150, 151 (Bankr. W.D. Ark. 1996); *Tri-State Homes Inc. v. Mears (In re Tri-State Homes Inc.)*, 56 B.R. 24, 26 (Bankr. W.D. Wis. 1985); *In re Ely*, 28 B.R. 488, 491-92 (Bankr. E.D. Tenn. 1983); *In re Missionary Baptist Found. of Am., Inc.*, 24 B.R. 970, 971 (Bankr. N.D. Tex. 1982). The progenitor of these cases was *United Merchs. & Mfrs. Inc. v. Equitable Life Assurance Soc'y of the U.S. (In re United Merchs. & Mfrs. Inc.)*, 674 F.2d 134 (2d Cir. 1982), which reached that conclusion under the Bankruptcy Act, but interpreted the Code in passing, as well. A leading commentary on bankruptcy supports the minority rule, which is unsurprising, since the author of Travelers' brief also authored the relevant section of the commentary. *See* 4 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 506.04[3][a][i] (15th ed. rev.).

Travelers inflates the number of courts in this camp, by citing numerous cases that awarded postpetition fees in connection with a debt that was *not dischargeable*. *See* Pet'r Br. at 25 (citing five such cases from courts of appeals). For reasons described below, the holdings of those cases (and of the only other court of appeals case cited by Travelers and decided under the Code) have no bearing on the question whether postpetition collection costs are allowable where, as here, the debt is dischargeable. *See infra* at 40 & n. 18.

One place to look for a qualifier is in § 502(b), the general provision on allowance of claims. That provision is not as clear, or capacious, as Travelers suggests. It provides that the court "shall determine the amount of such claim . . . *as of the date of the filing of the petition.*" § 502(b) (emphasis added). Then it directs the court to "allow such claim *in such amount*, except to the extent" the claim is disallowed either in that subsection or by some other provision of "applicable law." § 502(b) & (b)(1) (emphasis added). Even if Travelers' attorneys' fees claim falls within § 502(b), it is unclear how the allowable "amount of such claim . . . *as of the date of the filing of the petition*" would be anything other than zero.

To be sure, the provision goes on to say that a claim is not disallowed just because it is "contingent." § 502(b)(1). But the Code does not define "contingent." So this allowance provision leaves unanswered yet another key question: Would the drafters have considered an unsecured creditor's future decision whether or not to expend attorneys' fees in the bankruptcy proceeding to be the sort of contingency that could give rise to a recovery (as opposed to just an expense to be borne by the creditor)? It is hard to imagine they would have, in light of the next subsection, which directs the bankruptcy court to "estimate[] for purposes of allowance . . . any contingent . . . claim, the fixing . . . of which . . . would unduly delay the administration of the case." § 502(c). Unlike more conventional contingencies, a claim for postpetition attorneys' fees "as of the date of the filing of the petition" would be utterly incapable of *ex ante* estimation without a crystal ball. *See* Law Profs. at 5, 22.

Thus, even if § 502(b) were read in isolation, it would not be at all clear that any creditor—secured or unsecured—should be allowed to demand a refund of its own postpetition

attorneys' fees in the bankruptcy proceeding just because its contract provided for collection costs.

Any ambiguity is resolved, however, by another provision, § 506(b), which specifically addresses contractual fees, such as attorneys' fees. The relevant text reads:

> (b) *To the extent that* an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

§ 506(b) (emphasis added).[6] In this provision, Congress specifies that contractual attorneys' fees are allowed only for a creditor whose claim is secured by collateral that is *more valuable* than the debt owed. As most courts have held, this more specific provision means that fees are available only to a so-called "oversecured" creditor, and only to the extent of the creditor's "security cushion"—the amount by which the value of the property exceeds the principal of the claim.

1. Basic principles of statutory construction support the majority rule.

Four points of statutory construction support the majority rule, that unsecured creditors cannot claim postpetition attorneys' fees.

First, the structure of § 506(b) is: "*To the extent that* Condition X is true, Consequence Y shall attach." Normal parlance and elementary rules of logic dictate the obverse—that "[t]o the extent that" Condition X is *not* true,

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[6] Congress has since amended the provision to allow: "interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement *or State statute* under which such claim arose." 11 U.S.C. § 506(b) (2005) (amendment emphasized). The change has no bearing on the analysis that follows.

Consequence Y shall *not* attach. Any teenager knows that when Mom says, "*To the extent that* you have enough money, you can buy a car," she means the obverse, too: "You cannot buy a car if you don't have enough money," and "You certainly cannot buy a car if you're broke." So, too, with the Code. When Congress said, "*To the extent that*" a creditor is oversecured, "there shall be allowed . . . any reasonable fees . . . provided for under contract," Congress meant the obverse: To the extent that a creditor is not sufficiently secured, its claim for contractual attorneys' fees is not allowed. And the claim is certainly not allowed if the creditor is entirely unsecured.

The implication would be strong enough if Congress had merely declared, "An oversecured creditor's claim for contractual attorneys' fees is allowed." If that were all Congress had said, PG&E would be able to invoke the axiom, *expressio unius est exclusio alterius. See TRW, Inc. v. Andrews,* 534 U.S. 19, 28 (2001). But PG&E's position here is not a matter of negative implication, but of explicit negation. If the point were not so self-evident, it, too, would have a Latin name: *exclusio alterius est exclusio alterius.*

Second, Travelers' reading makes § 506(b) superfluous, which would flout this Court's directive that statutes are to be read to give meaning to every word. *See Duncan v. Walker*, 533 U.S. 167, 174 (2001). If all creditors—unsecured, undersecured, and oversecured, alike—*already* had an allowable claim for contractual attorneys' fees by virtue of § 502(b), then § 506(b) would serve no purpose. Surely, Congress did not craft a 67-word provision to give oversecured creditors a right that they—and all other creditors—already had.

Third, neither the definition of "claim" nor § 502(b)'s directive about allowing all claims says anything about attorneys' fees, much less about attorneys' fees sought by contract. In contrast, § 506(b) concentrates on "fees . . .

provided for under [an] agreement," such as the attorneys' fees at issue here. To promote the general implications of § 502(b) over the laser-like specificity of § 506(b) is to violate the precept that the specific trumps the general. *See Bulova Watch Co. v. United States*, 365 U.S. 753, 758 (1961). Since a general provision typically yields even when it is couched in seemingly absolute terms, *see Fourco Glass Co. v. Transmirror Prods. Corp.*, 353 U.S. 222, 228-29 (1957), it must be especially pliant where, as here, the general provision is ambiguous and Congress directed that it must yield to any contrary "applicable law." § 502(b)(1).

Fourth, when Congress intended to allow a party to recover attorneys' fees, it said so explicitly. There are at least 15 such circumstances in the Code—five of which entitle a *creditor* to collect attorneys' fees. *See infra* at 43 (cataloging the circumstances). When the Code does provide for fees, it almost always specifies that the fees must be at least reasonable, and typically that they must be necessary. *See infra* at 43-44. Congress's decision not to specify that such a huge class of unsecured creditors would routinely collect attorneys' fees by contract—and not to impose any limitation on the fees—can only mean that Congress did not intend them to. To argue otherwise is to presume that the drafters purposely obscured a mammoth in an anthill. *See Timbers*, 484 U.S. at 373 (rejecting a proposed interpretation of the Code because Congress would not have "obscured" the right sought in a broad and unrelated provision).

2. This Court confirmed this natural reading of the Code in *Timbers*.

This Court confirmed PG&E's reading of the Code in *Timbers*, 484 U.S. at 371-75. The ultimate question before the Court in *Timbers* involved an undersecured creditor's rights under a different provision. *See* § 362(d)(1) (governing the right of a secured creditor to seek "adequate protection" while a stay was in effect). En route to resolving

that question, this Court dissected § 506(b), interpreting it precisely as PG&E does here.

The Court began by observing that "[s]ection 506 of the Code defines the amount of the secured creditor's allowed secured claim and the conditions of his receiving postpetition interest." 484 U.S. at 371. Since "the conditions of his receiving postpetition interest" are the same as the conditions of his receiving "any reasonable fees, costs or charges provided for under the agreement," anything this Court said about the one must apply to the other. The Court drew several conclusions that resolve this case.

First, this Court characterized § 506(b) as a provision that had the "substantive effect of *denying undersecured creditors postpetition interest on their claims*—just as it *denies* oversecured creditors postpetition interest to the extent that such interest, when added to the principal amount of the claim, will exceed the value of the collateral." *Id.* at 372 (emphasis changed). The Court reached that conclusion by focusing largely on the first few words of § 506(b), "'*[t]o the extent that*,'" and concluding that these words must mean to that extent and no more. *Id.* Based upon this natural reading, the Court concluded that "this provision permits postpetition interest to be paid *only out of the 'security cushion.*'" *Id.* (emphasis added). That conclusion, in turn, led this Court to hold that "the undersecured creditor, who has no such cushion," cannot collect postpetition interest. *Id.* at 373.

The same analysis applies, *mutatis mutandis*, to attorneys' fees. Just as the emphasized words in § 506(b)—"'*[t]o the extent that*'"—demonstrate that "this provision permits postpetition interest to be paid only out of the 'security cushion,'" the same must be true of postpetition "fees, costs, or charges." *Id.* at 372. Just as § 506(b), therefore, has the "substantive effect of denying undersecured creditors postpetition interest on their claims,"

id., that same language has the "substantive effect of denying undersecured creditors postpetition [fees, costs or charges] on their claims." "[J]ust as [§ 506(b)] denies oversecured creditors postpetition interest to the extent that such interest, when added to the principal amount of the claim, will exceed the value of the collateral," *id.*, the same provision has the same effect on postpetition "fees, costs, or charges." And if "the undersecured creditor" cannot collect postpetition interest because it "has no such cushion," *id.* at 373, an unsecured creditor cannot collect postpetition fees either.

In fact, this Court's meticulous examination of § 506(b) applies with even *greater* force here. In *Timbers*, an undersecured creditor was blocked from foreclosing on a property by virtue of bankruptcy's automatic stay, *see* § 362, and the creditor sought compensation for the lost income it would have collected had it been allowed to foreclose and then reinvest the proceeds. 484 U.S. at 368-69. In isolation, the provision the creditor invoked, § 362(d)(1), could plausibly be read to provide such compensation; it affords a secured creditor "adequate protection of an interest in property," which could arguably include protection of the state-law right to foreclose on its collateral in the event of default. This Court rejected the argument, latching onto § 506(b)'s reference to the circumstances under which secured creditors can recover "interest." *Id.* at 372-73. The creditor argued that forgone reinvestment income (which could mean lost income calculated at the prevailing rate of return) is distinct from interest (which could mean interest prescribed by contract). *Id.* at 369. Although this was a plausible basis on which to reconcile the creditor's position with the limitations on "interest" in § 506(b), this Court concluded that the creditor's position "must be regarded as contradicting the carefully drawn disposition of § 506(b)." *Id.* at 373. Travelers' interpretation of the Code presents a contradiction that is more direct. After all, the attorneys'

fees sought here are unambiguously covered in § 506(b)'s reference to "fees"; there is no way to allow Travelers' claim and still give meaning to that word in § 506(b).

There is one difference between the postpetition "interest" this Court was considering in *Timbers* and the postpetition "fees, costs, or charges" it confronts here: The Code elsewhere specifies that a "claim . . . for unmatured interest" is disallowed, § 502(b)(2), but § 502 has no explicit disallowance for attorneys' fees or other costs or charges. But that is no basis on which to distinguish *Timbers*. *See Pride*, 285 B.R. at 375. The creditor's argument in *Timbers* drew upon an independent source of compensation (§ 362(d)), one not negated by § 502(b). Thus, while *Timbers* acknowledged this disallowance provision with a passing citation, *see* 484 U.S. at 372-73, the provision had little bearing on the Court's analysis. The cynosure for the Court was the structure and language of § 506, which treats postpetition interest the same as all other ancillary obligations "provided for under the agreement."

This last point exposes yet another statutory clue of the drafters' intentions: It would have made no sense for Congress to draft a provision purporting to put all these ancillary obligations on the same footing—"interest on such claim, and any reasonable attorneys fees, costs, or charges provided for under the agreement"—if it intended to put them on different footing. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 n.5 (1989) (observing that Congress must have intended to accord the same treatment to each of the expenses addressed in § 506(b)).

Why, then, did the drafters neglect to insert into § 502(b) an express disallowance for postpetition attorneys' fees as it did for unmatured interest? It may be because they believed that § 502(b) already yielded that result by its command to calculate an allowable claim "as of the date of the filing of the petition," § 502(b) or that expenses on attorneys' fees are

simply not "contingent," within the meaning of § 502(b)(1). If so, then the drafters would still have had to expressly exclude unmatured interest in § 502(b), but would have had no reason to do the same with postpetition attorneys' fees.[7] Alternatively, as is explained below, it may be that it never dawned on the drafters that anyone would consider an unsecured creditor's demand for prospective attorneys' fees to be a distinct allowable claim, because no court had treated them as such for the entire 80-year life of the predecessor statute. *See infra* at 30-36, 37-38.

3. Any alternative reading makes no sense.

Most of the courts in the minority camp either predate or ignore *Timbers*. A few, however, address § 506(b), but only by offering a strained reading of its plain language. *See, e.g., New Power Co.*, 313 B.R. 496, 509 (Bankr. N.D. Ga. 2004). According to this contrary position, § 506(b) does not actually authorize oversecured creditors to collect attorneys' fees, as it seems to do (for this theory presumes that § 502(b) does that already). Rather, the theory goes, § 506(b) merely dictates that *when* an oversecured creditor has a contractual right to attorneys' fees (or other costs or charges), those fees, like the underlying debt, are *also* secured. *Id.* This reading

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[7] As the drafters were well aware, it is common for a debtor to sign a note with a face value of, say, $5,000, while the amount actually lent was a lesser sum, say, $4,500. On the first day of the loan, the $500 differential would be *unmatured* interest. The principal would be paid at some stated date in the future, along with the (now *matured*) hidden interest, when the $5,000 note comes due. For any date in between, the $500 of interest could be pro-rated into its matured and unmatured portions. If the face value of every claim were permitted as an allowed claim in § 502(b), then unmatured interest would also be part of the claim. Hence the need for express exclusion of such interest in § 502(b). *See Tex. Commerce Bank, N.A. v. Licht (In re Pengo Indus., Inc.)*, 962 F.2d 543, 546-47 (5th Cir. 1992); H.R. REP. NO. 95-595, at 352-54 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6308-10.

is at war with this Court's analysis of the same provision in *Timbers*. But even on the face of the Code, there would be two problems with this reading.

First, § 506(b) was not necessary to achieve that result either—so it would still be superfluous. To the extent of the security cushion, § 506(b) "allows" to the holder "interest" as well as "fees, costs, or charges" provided for under agreement. Assume, for argument's sake, that such "fees" were *already* allowed under § 502, as Travelers contends. If so, these fees would also be "secured" by operation of § 506*(a)*, the immediately preceding subsection, which provides:

> (a) An allowed claim of a creditor secured by a lien on property . . . is a secured claim to the extent of the value of such creditor's interest . . . in such property, and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. . . .

There would be nothing left for § 506(b) to do.

Second, if § 506(a) did not achieve that end, § 506(b) certainly would not do it. Section 506(b)does not specify one way or the other whether an obligation to pay fees is secured. When the creditor holds "an allowed *secured* claim," *and* the creditor is oversecured, *and* fees are "provided for under the agreement under which such claim arose," then § 506(b) says only one thing about attorneys' fees: "reasonable fees" and other costs "shall be allowed." In short, if, under those circumstances, fees are treated as secured, it is not because § 506(b) makes them so.

Thus, if we were to indulge Travelers' assumption that contract-based attorneys' fees are generally allowable to *all* creditors by virtue of § 502(b), there is no reading of § 506(b) that would save it from the statutory equivalent of an existential crisis. Section 506(b) cannot possibly be there

to make sure an allowed claim is secured; it is there to address obligations that would not otherwise be allowed—or it would serve no purpose at all. Put another way, it is true that, with respect to fees, § 506(b) plays an essential role in honoring the security interest of an oversecured creditor, but § 506(b) is so required *because*, without the provision, the fees would not be allowed at all.

Notably, the § 506 couplet furnishes another revealing clue that Congress does not share Travelers' view that a contractual obligation to pay attorneys' fees is an allowable claim in its own right (courtesy of § 502(b)): Section 506(a) and (b) use the phrase "allowed claim" and "allowed secured claim" to describe the *underlying* obligation. But the drafters pointedly avoided using either simple phrase to describe the obligation to pay attorneys' fees, opting instead for an awkward circumlocution: "there shall be allowed to the holder of *such* claim"—meaning the holder of the underlying "allowed secured claim"—"any reasonable fees . . . provided for under the agreement." This formulation indicates that Congress did not think that either the "interest on *such* claim" or "any reasonable fees, costs, or charges provided for under the agreement under which *such* claim arose" had the status of allowed claims in their own right.

B. The Bankruptcy Code's Structure and Purpose Confirm that Congress Did Not Intend to Allow Unsecured Creditors to Recover Attorneys' Fees.

As this Court pointed out, also in *Timbers*, "[a] provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because . . . only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." 484 U.S. at 371 (citations omitted). A rule allowing every unsecured creditor with a contract—every credit card company, every noteholder—to bloat its proportional recovery with postpetition attorneys' fees would be incompatible with the

"remainder of the statutory scheme" in almost every conceivable way. One could fill a whole brief describing the depth of the incompatability—and Amici do. *See* Law Profs. at 4-7, 14-23. For this brief, a summary must suffice.

First, a dominant feature of the Code—and bankruptcy policy dating back centuries—is the temporal divide between pre- and postpetition events. It was nearly a century ago that this Court observed, "For more than a century and a half the theory of the English bankrupt[cy] system has been that everything stops at a certain date." *Sexton v. Dreyfus*, 219 U.S. 339, 344 (1911). The whole point of a bankruptcy petition is to "freeze . . . the *status quo*." *Hillis Motors, Inc. v. Hawaii Auto. Dealers' Ass'n*, 997 F.2d 581, 585 (9th Cir. 1993). Numerous Code provisions attach different consequences to an event depending upon whether it occurred pre- or postpetition, fundamentally altering state law rights from the moment the petition is filed. *See, e.g., NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 532 (1984); §§ 362 (automatic stay), 547(b) (avoidability of preferential transfers), 549(a) (avoidability of postpetition transactions), 552(a) (postpetition effect of security interest). One provision already discussed illustrates the principle in action: A creditor can assert a claim for interest under a contract—but only up until the petition date. As we have seen, if the creditor is unsecured, the Code cancels any contractual right to interest that would have accrued postpetition. *See* § 502(b)(2). The creditor's state law rights are curtailed even though the "commercial parties" "allocate[d] the burden" of interest payments "contractually . . . and price[d] their goods and services accordingly." Pet'r Br. at 4.

Second, as Travelers acknowledges, ingrained in the Code is the equally venerable bankruptcy "theme of . . . equality of distribution." *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941); *see Bruning v. United States*, 376 U.S. 358, 362 (1964); Pet'r Br. at 46

(citing additional cases). "[I]f one claimant is to be preferred over others, the purpose should be clear from the statute." *Nathanson v. NLRB*, 344 U.S. 25, 29 (1952). That does not mean, as Travelers suggests, that an unsecured creditor's postpetition collection efforts must be treated the same as all sorts of prepetition debts. *See* Pet'r Br. at 45-46, 49. "[E]quality among creditors" is measured "as of the date of insolvency," which is why (to continue with the same illustration) "interest accruing thereafter is not considered." *Ticonic Nat'l Bank v. Sprague*, 303 U.S. 406, 411 (1938). Thus, equality means that, as of the petition date, unsecured creditors share and share alike. It also means that an unsecured creditor cannot "improve his position vis-à-vis other creditors by action taken by him postpetition." *In re Cotton Mktg., Inc.*, 737 F.2d 1338, 1342 (5th Cir. 1984).

Travelers' proposed rule would violate this principle by giving one large subclass of unsecured creditors free rein to inflate its claim or voting power relative to all others. Contrary to Travelers' assertion, this rule does not "promote[] equality of distribution among creditors," Pet'r Br. at 45, any more than primogeniture promotes equality of distribution among sons. *See* Law Profs. at 17-18.

Third, largely for the foregoing two reasons, and also to maximize the estate, the Code adheres to the longstanding bankruptcy policy of never allowing an unsecured creditor to collect its postpetition attorneys' fees from the estate unless the creditor is acting for the benefit of the estate (and all the other creditors). § 503(b)(3)-(4) (codifying *Randolph & Randolph v. Scruggs*, 190 U.S. 533, 539 (1903) ("We are not prepared to go further than to allow compensation for services which were beneficial to the estate.")). Because Travelers was acting to advance only its own interests, it has no right to collect its "administrative expenses." § 503. Travelers cannot create such a right by dressing them up as

"contingent" claims allowable under § 502. *See* Law Profs. at 11-12 (citing numerous cases).

Finally, as Travelers points out, the Code revolves around the "twin goals of maximization of realization on creditors' claims and of prompt and efficient administration of the estate." Pet'r Br. at 47 (internal quotation marks and citations omitted). Allowing unsecured creditors to claim postpetition attorneys' fees would defeat both these goals. As noted above, fee-shifting provisions are ubiquitous. *See supra* at 13. Amici describe the feeding frenzy that will ensue if every unsecured creditor with a fee-shifting provision could enhance its recovery by incurring attorneys' fees, consuming the estate along the way and overwhelming courts with a veritable avalanche of ancillary litigation over the meaning of fee provisions and the reasonableness of fees. Law Profs. at 18-21. Contractual debts that would otherwise have been the easiest sorts of claims to quantify will now be the most illiquid and controversial.

This case provides a most unpalatable glimpse of the world according to Travelers: The underlying debt in this case was $0.00. Yet the creditor presented the debtor with a $167,000 claim for attorneys' fees for its intermeddling. The debtor had to pay about the same amount to its own lawyers to respond. Both parties have expended many multiples of that amount litigating over the nature and amount of the attorneys' fees obligation, at four levels of the federal judiciary. If Travelers prevails here, the litigation will not be over; the parties will continue to litigate over the meaning of the attorneys' fees provision in these contracts and over what was reasonable. *See Sakowitz*, 110 B.R. at 275. When that is done, the creditor will almost certainly present the debtor with a bill for all the appeals—and the parties will then start anew, litigating over the debtor's obligation to pay *that* bill. If this scenario becomes the norm, administration of the estate will be neither prompt nor efficient, and bankruptcy

lawyers will gorge themselves on the estate, leaving little to split among the creditors.

None of these concerns applies to oversecured creditors. When a creditor bargains to secure a debt with specific property, the creditor has a property interest as a lienholder in that asset, effectively putting the property out of reach of all other creditors—and essentially out of the reach of the estate itself unless and until the secured creditor is fully repaid. *See Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 588 (1935). The secured creditor, then, begins with a position that is superior to the position of unsecured creditors, and the Code honors that preferred position—eschewing equality with unsecured creditors—up to the value of the collateral. *See* § 506; *Timbers*, 484 U.S. at 374. Thus, the rights of secured creditors routinely breach the temporal divide. *See infra* at 32-36 (discussing *Security Mortgage*). Precisely because the collateral is already out of reach of other creditors, the secured creditor is not enlarging its share of the estate vis-à-vis other creditors when it collects postpetition fees and interest. Moreover, because secured creditors are typically less numerous than unsecured creditors and limited by the value of their collateral, allowing them to collect fees does not raise the same concerns about administration or depletion of estate assets.

In sum, the consequences of the rule Travelers proposes—putting unsecured creditors on a par with secured creditors with respect to fees—are so antithetical to the Bankruptcy Code's rudiments that a court would be tempted to find a way to avoid the result even if the Code had clearly prescribed it. But since Travelers' position is built on congressional silence about attorneys' fees in one ambiguous provision and defies the explicit direction of another, language and sound policy align against Travelers' position.

C. History Confirms that Congress Did Not Intend to Award Postpetition Attorneys' Fees to Unsecured Creditors.

History, too, confutes Travelers' reading of the Code. The parties agree that this Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990); *see* Pet'r Br. at 43. But Travelers' account of the history elides the critical point, that the historical rule was the one now reflected in § 506(b): Oversecured creditors can recover attorneys fees; unsecured creditors cannot. In light of that backdrop, it would have been anathema for the drafters to grant attorneys' fees to an unsecured creditor—which could explain why the drafters did not bother (or think) to insert a specific disallowance into § 502(b).

Early Bankruptcy Act. As far back as one might care to look, the rule was that an unsecured creditor could not claim attorneys' fees, even if provided by contract. In one of its first cases under the Bankruptcy Act of 1898, Ch. 541, 30 Stat. 544 (repealed 1979), this Court confronted a prepetition contract in which the debtor promised to pay the creditor's postpetition attorneys' fees. *See Randolph*, 190 U.S. at 538; Law Profs. at 9-10 (discussing *Randolph*). In *Randolph*, this Court disallowed a contractual claim for the unsecured creditor's postpetition attorneys' fees, except "so far as they benefited the estate" (the same rule that persists in the modern Code today). 190 U.S. at 539-40; *see* § 503(b) (codifying *Randolph*).

For the early decades of the Act, *no creditor* could recover postpetition attorneys' fees prescribed by contract—

whether unsecured[8] or secured.[9] The Bankruptcy Act reached that result by limiting claims to "a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition." Bankruptcy Act § 63(a), 11 U.S.C. § 103(a)(1) (1934 & Supp. III 1937) (repealed 1979). So if a right to attorneys' fees accrued prepetition, the fees were recoverable in bankruptcy, *see Merchant's Bank v. Thomas*, 121 F. 306, 312 (5th Cir. 1903), but where the attorneys' fees had not accrued at the time of the filing of the petition, "the fees did not become, within the purview of section 63, a provable debt against the estate of the bankrupt." *T.H. Thompson*, 144 F. at 315; *see Gebhard*, 140 F. at 573 (on the petition date "[t]he obligations of the bankrupt were then fixed, and his estate could not be charged by that which subsequently occurred").

Congress enlarged the scope of "provable claims" in 1938. As Travelers points out, *see* Pet'r Br. at 43 n.9, this amendment meant that a creditor could also prove certain "contingent debts and contingent contractual liabilities."

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[8] *See, e.g., Merchant's Bank v. Thomas*, 121 F. 306, 309 (5th Cir. 1903); *McCabe v. Patton*, 174 F. 217, 219 (3d Cir. 1909); *In re Keeton, Stell & Co.*, 126 F. 426, 428 (W.D. Tex. 1903); *In re Gebhard*, 140 F. 571, 573 (M.D. Pa. 1905); *In re T.H. Thompson Mill Co.*, 144 F. 314, 315 (W.D. Tex. 1906); *In re Edens Co.*, 151 F. 940, 941 (D.S.C. 1907); *In re Harris*, 272 F. 351, 352 (M.D. Pa. 1921).

[9] *See In re Roche*, 101 F. 956, 960 (5th Cir. 1900); *Mechanics'-Am. Nat. Bank v. Coleman*, 204 F. 24, 32 (8th Cir. 1913); *British & Am. Mortgage Co. v. Stuart*, 210 F. 425, 428-30 (5th Cir. 1914); *In re Gimbel*, 294 F. 883, 885-86 (5th Cir. 1923); *First Sav. Bank & Trust Co. v. Stuppi*, 2 F.2d 822, 824-25 (8th Cir. 1924); *In re Garlington*, 115 F. 999, 1000 (N.D. Tex. 1902); *In re Hershey*, 171 F. 1004, 1008 (N.D. Iowa 1909); *In re V. & M. Lumber Co.*, 182 F. 231, 239 (N.D. Ala. 1910); *In re Ledbetter*, 267 F. 893, 895-96 (N.D. Ga. 1920) (secured creditor's attorneys' fees and costs incurred prepetition are provable; those incurred postpetition are not).

Bankruptcy Act § 63(a)(8), 11 U.S.C. § 103(a)(8) (1976) (repealed 1979). But the key question under the Act (as under the Code) was whether the claim was "allowed," and Travelers neglects to mention that the Act still made clear "[t]hat an unliquidated or contingent claim shall not be allowed" where "it is not capable of liquidation or of reasonable estimation" "within the time directed by the court." *Id.* § 57(d), 11 U.S.C. § 93(d) (1976) (repealed 1979). Postpetition attorneys' fees obviously fail this test, and no case in the ensuing four decades leading up to the adoption of the Code ever held otherwise.[10]

Security Mortgage. Travelers correctly points out that this Court's decision in *Security Mortgage Co. v. Powers*, 278 U.S. 149 (1928), changed some of the rules. *See* Pet'r Br. at 43. But the rules changed only for *oversecured* creditors, not for unsecured creditors.

Security Mortgage involved an *over*secured creditor that claimed a right to postpetition fees under a state statue. 278 U.S. at 152-54. The Court agreed that an oversecured creditor could claim attorneys' fees. In so holding, the Court did not overrule *Randolph*, nor even mention the case, for it was evident that the *Security Mortgage* analysis was inapplicable to unsecured creditors. The Court began its analysis by observing that "[u]nder section 67 of the Bankruptcy Act *the trustee takes property subject to valid liens* existing at the time of the institution of the bankruptcy

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[10] Before Congress adopted the Code, the only suggestion to that effect was dictum in a single Ninth Circuit case. *See Hartman v. Utley*, 335 F.2d 558, 559 (9th Cir. 1964). The Ninth Circuit *disallowed* a postpetition claim for attorneys' fees by an unsecured creditor. *Id.* at 560-61. Along the way, the Ninth Circuit expressed the view that the 1938 Amendment would allow such a claim in other circumstances. Not a single published decision, within the Ninth Circuit or anywhere else, followed, or even cited, that dictum before 1978, when Congress enacted the Code.

proceedings." *Id.* at 153 (emphasis added). This meant that any property that was subject to a lien was simply outside the estate—out of the reach of other creditors—and, thus, not subject to the Act's restrictions on claims against the estate. *See In re Bain*, 527 F.2d 681, 686-87 (6th Cir. 1976). That was why the Court emphasized that "the [secured creditor] does *not* seek to prove the claim *in bankruptcy*. It asks to have it allowed as a part of the principal debt, which is *secured by a lien* upon the property sold." 278 U.S. at 153 (emphasis added).[11]

In other words, the question before the Court was not whether the creditor had a separate claim for attorneys' fees that was provable in the bankruptcy proceeding. The question under the Act was what state law considered to be the size of the debt that was secured by the lien and what amount was, therefore, outside the debtor's estate. *See Sakowitz*, 110 B.R. at 271; *see also James Talcott, Inc. v. Wharton (In re Cont'l Vending Mach. Corp.)*, 543 F.2d 986, 992 (2d Cir. 1976). The Court emphasized the point repeatedly, observing that the issue was the "[t]he *validity of the lien* claimed by the mortgage company for attorney's fees," 278 U.S. at 153 (emphasis added), and characterizing the claim as one "that . . . may be enforced *against the land held as security*," *id.* at 154 (emphasis added).

Nothing changes for unsecured creditors. In the intervening half century—after this Court decided *Security*

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[11] These clear statements are not negated by the Court's subsequent, rather imprecise, comment that "the obligation to pay attorney's fees presents no obstacle to enforcing it in bankruptcy, either as a *provable claim* or by way of a lien." 278 U.S. at 154 (emphasis added). The case before the Court had nothing to do with a "provable claim." *See Sakowitz*, 110 B.R. at 271. And at the time, as we have seen, there was no doubt that a claim that was either unliquidated or contingent was *not* provable.

Mortgage and before Congress adopted the Code—the lower courts hewed to this limited view of *Security Mortgage*.[12] The courts did not apply the *Security Mortgage* result to unsecured creditors, because unsecured creditors most certainly *were* making claims against the estate. *See In re Glenn*, 2 F. Supp. 579, 593 (W.D.S.C. 1932) ("So far as attorneys' fees being a claim against the general estate as distinguished from the specific property covered by the various mortgages, these fees are allowable as a claim only where they were placed in the hands of the attorney prior to bankruptcy."). While one or two courts in that timeframe may have been confused about the extent to which the *Security Mortgage* rule could be applied to secured creditors who were *under*secured,[13] not a single court over the ensuing half century invoked *Security Mortgage* for the proposition

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[12] *See In re Am. Motor Prods. Corp.*, 98 F.2d 774, 775 (2d Cir. 1938) ("[Creditor] is not seeking to prove any claim in bankruptcy but merely to have the amount of an agreed counsel fee allowed as part of the principal debt covered by a lien on the property sold."); *Bain*, 527 F.2d at 685 ("The fee at issue here is not a claim against the estate; it is a part of a debt secured by deeds of trust."); *In re Cont'l Vending Mach.*, 543 F.2d at 993 ("'The appellee here is not seeking to prove any claim in bankruptcy but merely to have the amount of an agreed counsel fee allowed as part of the principal debt covered by a lien on the property sold.'" (citations omitted)); *In re Mill City Plastics*, 129 F. Supp. 86, 91 (D. Minn. 1955) (finding, based on *Security Mortgage*, that "value of [attorneys' fees] are allowable, not as a provable claim, but as part of the principal debt which is also secured by a lien upon the property sold"); *In re Schafer's Bakeries*, 155 F. Supp. 902, 912 (E.D. Mich. 1957) ("claim for attorney fees and expenses became a part of the original debt secured by valid liens").

[13] *See In re Ferro Contracting Co.*, 380 F.2d 116, 120 (3d Cir. 1967) (allowing a secured creditor who was undersecured to collect attorneys' fees, without revealing whether the fees were incurred pre- or postpetition); *LeLaurin v. Frost Nat'l Bank of San Antonio*, 391 F.2d 687, 691 (5th Cir. 1968) (allowing a secured creditor who was undersecured to collect attorneys' fees, without addressing why such fees were allowed under the Bankruptcy Act).

that a completely *un*secured creditor could collect attorneys' fees under a contract. So far as appears from published cases before Congress enacted the Code, neither the courts nor the litigants even considered the point arguable.[14]

Thus, if the drafters of the Code had scoured the published cases, they would have found the two categories of cases Travelers invokes: (1) numerous cases in which *secured* creditors (almost entirely *over*secured creditors) collected *post*petition attorneys fees;[15] and (2) cases in which creditors of all sorts collected *pre*petition attorneys fees.[16] These are the only categories of pre-Code cases Travelers cites when it announces that "[f]ollowing this Court's decision in *Security Mortgage*, courts routinely allowed

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[14] Four years *after* Congress passed the Code, the Second Circuit granted postpetition fees to an unsecured creditor in a case arising under the Bankruptcy Act. *United Merchs.*, 674 F.2d at 138-39. Even so, the court did not question the district court's observation that "not a single decision has been found allowing an unsecured creditor to assert . . . a claim" for postpetition attorneys' fees. *In re United Merchs. & Mfrs., Inc.*, 10 B.R. 312, 314 (S.D.N.Y. 1981), *rev'd*, 674 F.2d 134 (2d Cir. 1982). In any event, the Code's drafters would not have known about this case nor about the several cases that followed its incorrect rendering of *Security Mortgage*. *See also Worthen Bank & Trust, N.A. v. Morris*, 602 F.2d 826, 829 (8th Cir. 1979) (post-Code case, granting attorneys' fees to an undersecured creditor under the Act, without analyzing Code).

[15] *In re Cont'l Vending Mach.*, 543 F.2d at 993 (creditor was secured and therefore was "not seeking to prove any claim in bankruptcy but merely to have the amount of an agreed counsel fee allowed as part of the principal debt covered by a lien on the property sold" (internal quotation marks and citation omitted)); *LeLaurin*, 391 F.2d at 691; *Ferro*, 380 F.2d at 119-20; *Am. Motor Prods.*, 98 F.2d at 775; *Schafer's Bakeries*, 155 F. Supp. at 912.

[16] *See Mills v. E. Side Investors (In re E. Side Investors)*, 702 F.2d 214, 215 (11th Cir. 1983) (case decided *after* enactment of the Code, and involving a *secured* creditor, holding that "[t]he filing of a petition . . . does not diminish the debtor's obligation for attorney fees *if vested when the petition is filed*" (emphasis added)).

claims for attorneys' fees if the creditor was entitled to fees under applicable state law." Pet'r Br. at 43; *see also id.* at 42 (same). This assertion is about as helpful as an apostate's plea to Saint Peter that "God routinely lets souls into heaven." Technically accurate, but hardly persuasive.

The Code. In light of this backdrop, a shift to a rule that unsecured creditors can collect their contractual attorneys' fees postpetition would have been nothing short of tectonic. If the drafters had intended such a shift, one would expect that they would have made their intention explicit. *See Davenport*, 495 U.S. at 563. Moreover, if Congress intended to risk depleting estates and overwhelming courts with a flood of litigation over fees, to blur the traditional line between pre- and postpetition, to abandon the rule that unsecured creditors could never garner fees without benefiting the estate, and to toy with the usual rules of equality of distribution, *see supra* at 25-28, at the very least *someone* would have explained why that might be a good idea, or at least mentioned that it was happening.

Instead, Congress codified the existing rule in § 506(b), which reflects the double-edged allowance for oversecured creditors and disallowance for others. *See* H.R. REP. NO. 95-595, at 356-57 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6312 (interpreting § 506(b) as "codif[ying] current law by entitling a creditor with an oversecured claim to any reasonable fees, costs, or charges provided under the agreement under which the claim arose"). And the legislative history provides not a hint that any more fundamental change was in the offing. No Member of Congress, no Senator, and no committee so much as

suggested that the venerable rule for unsecured creditors should or would be changed.[17]

Travelers correctly points out that one of the Code's major innovations was an expansive definition of the word "claim." § 101(5); *see* Pet'r Br. at 43 n.9. The purpose was not to expand creditors' rights, but to reach a more comprehensive resolution of the debtor's outstanding liabilities. The all-embracing definition meant that a much broader range of debts and potential debts could be canceled—"discharged," in the Code's parlance—when the bankruptcy case ended. *See* §§ 524, 1141(d). Even debts that are contingent upon the filing of the petition, and never mature during bankruptcy proceeding, are now discharged. So, too, are debts that cannot easily be estimated. § 502(c).

This legislative backdrop provides one further explanation of why Congress did not tack onto § 502(b) a more explicit disallowance for postpetition attorneys' fees, as it did, for example, for "unmatured interest." § 502(b)(2). One explanation, already mentioned above, is that the drafters thought it unnecessary. *See supra* at 22-23. An alternative explanation is that the drafters did not conceive of the possibility that, technically, the expanded definition of "claim" could be read to encompass contractual obligations to pay attorneys' fees. Such a lapse might be mystifying i

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[17] The debate over bankruptcy reform lasted ten years. The legislative history is splayed over 17 volumes, *see Bankruptcy Reform Act of 1978: A Legislative History* (Alan N. Resnick & Eugene M. Wypyskii eds., 1979), with a commission study, three committee reports, and thousands of pages of floor debate. PG&E has searched the history and discovered not a single reference to the concept of allowing unsecured creditors to recover postpetition attorneys' fees by contract. *See, e.g.*, H.R. REP. No. 95-595, at 308-09, 356-57 (1997), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6265-66, 6312-13 (analysis of § 101 definition of "claim" and § 506); S. REP. No. 98-989 at 21, 62-65, 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5807-08, 5848-51, 5854 (same).

courts had been routinely doling out postpetition attorneys' fees to unsecured creditors when the drafters were doing their handiwork, or even if the issue had been the subject of extensive pre-Code litigation, or discussion among the drafters, as unmatured interest was. *See supra* at 22-23 & n.7. But since not a single court allowed such a claim for the entire 80-year life span of the predecessor statute—or before—the lapse (if that's what it was) is at least explicable. Whatever the explanation, Congress did not speak with anywhere near the clarity that would be necessary to upend centuries of bankruptcy practice and to undermine bankruptcy policy so thoroughly.

D. None of this Court's Precedents Supports the Conclusion that Unsecured Creditors Can Assert a Claim for Postpetition Attorneys' Fees.

For precedential support Travelers relies mainly on *Security Mortgage*. It argues: "[A]s the Court explained long ago in *Security Mortgage*, Congress has elected not to prohibit *recovery in bankruptcy* of an *unsecured* claim for attorneys' fees that is valid under state law." Pet'r Br. at 28 (emphasis changed). As noted immediately above, *see supra* at 32-36, the statement is doubly false. First, *Security Mortgage* had nothing at all to say about "an unsecured claim," and its rationale was valid only for oversecured claims. Second, the whole point of the case was that the oversecured creditor was simply not making a "recovery in bankruptcy." *See, e.g.*, *Sakowitz*, 110 B.R. at 271.

Travelers' reliance on *Cohen v. de la Cruz*, 523 U.S. 213 (1998), is even more misplaced. *See* Pet'r Br. at 24-25. That case was not about the interplay between § 502(b) and §506(b). It was not even about whether a claim for postpetition attorneys' fees is generally *allowable*, under contract or otherwise. The case was about § 523(a), which dictates the circumstances under which a debt cannot be *discharged* from bankruptcy—i.e., when the liability

survives the bankruptcy, and the debtor remains liable for the entire debt even after the bankruptcy case is over. *See* 523 U.S. at 214-15. The specific provision at issue dictates that a liability will not be discharged "to the extent obtained by . . . actual fraud." § 523(a)(2)(A). The question before the Court was whether this provision would prohibit discharge also of a fraud-related liability for treble damages, attorneys' fees, and costs. 523 U.S. at 215.

The Court held "that § 523(a)(2)(A) prevents the discharge of all liability arising from fraud, and that an award of treble damages therefore falls within the scope of the exception." *Id.* Having decided that knotty issue of statutory construction, the Court concluded that any "attorney's fees and costs" that were appended to the liability also had to be "nondischargeable in bankruptcy." *Id.* at 223.

Travelers asserts that this conclusion was tantamount to "holding . . . a creditor's claim for attorneys' fees properly constitutes an *allowable* 'claim' in a debtor's bankruptcy case." Pet'r Br. at 25 (emphasis added). That is a non sequitur. When a bankruptcy court encounters a potential liability that may not be discharged, it treats that particular claim as if no bankruptcy petition had ever been filed. *See In re Williams*, 227 B.R. 589, 593 (D.R.I. 1998). If the creditor would have been entitled to recover ancillary charges (whether attorneys' fees or interest) for prevailing on the claim outside the bankruptcy proceeding, under nonbankruptcy law, the creditor can recover those charges as part of the judgment in the bankruptcy court. *See Leeper v. Pa. Higher Educ. Assistance Agency*, 49 F.3d 98, 101-03 (3d Cir. 1995) (while § 502(b)(2) bars claims for unmatured interest against the estate, it does not preclude accrual of interest on nondischargeable debts). That is all *Cohen* held. That does not translate into a rule that attorneys' fees are always allowable claims for unsecured creditors where, as here, the underlying claim *is* dischargeable. *See Deutsche*

Fin. Servs. Corp. v. Osborne (In re Osborne), 257 B.R. 28, 34 n.3 (Bankr. C.D. Cal. 2000) ("*Cohen* does not affect" attorneys' fees determinations in "cases involving non-523(a) issues").

For this same reason, Travelers is incorrect when it tallies up a series of court of appeals cases in support of the proposition that postpetition attorneys' fees are generally allowable to unsecured creditors by contract. *See* Pet'r Br. at 25. Almost every court of appeals case Travelers cites in support of its position on the merits (and cited at the cert. stage in support of the assertion of a circuit conflict) falls into the *Cohen* mold: They involved fees attached to a judgment of liability, where the underlying judgment, and hence the contractual or statutorily prescribed fees, were held to be *nondischargeable*.[18] *See* Law Profs. at 16-17 & n.11.

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[18] In support of its position, Travelers cites only six court of appeals cases interpreting the Code (as opposed to the Act). Five of them fall into this category. *See Alport v. Ritter (In re Alport)*, 144 F.3d 1163, 1168 (8th Cir. 1998) (creditor's "attorney's fees were properly included in the nondischargeability debt under § 523(a)(2)(A)"); *Davidson v. Davidson (In re Davidson)*, 947 F.2d 1294, 1298 (5th Cir. 1991) ("where a party has contracted to pay attorneys' fees for the collection of a nondischargeable debt, the fees also will not be discharged in bankruptcy"); *Transouth Fin. Corp. v. Johnson*, 931 F.2d 1505, 1508-09 (11th Cir. 1991) ("Once a debt has been determined nondischargeable, a creditor's attorney's fees, if provided for by contract, are included as part of the nondischargeable debt."); *Jordan v. Southeast Nat'l Bank (In re Jordan)*, 927 F.2d 221, 227 (5th Cir. 1991), *overruled on other grounds by Coston v. Bank of Malvern*, 991 F.2d 257 (5th Cir. 1992); *Martin v. Bank of Germantown (In re Martin)*, 761 F.2d 1163, 1167-68 (6th Cir. 1985) ("523(a)(2)(B) excepts from discharge the whole of any debt incurred by use of a fraudulent financial statement, and such a debt includes state-approved contractually required attorney's fees").

The sixth one, *Three Sisters Partners, LLC v. Harden (In re Shangra-La, Inc.)*, 167 F.3d 843 (4th Cir. 1999), was also governed by a different provision. It involved a situation in which a creditor incurred attorneys' fees in connection with a bankruptcy and the debtor then

E. The Court Should Resolve this Controversial Question of Statutory Interpretation, Even Though It Was Not Addressed Below.

Because *Fobian* was the controlling law, PG&E did not assert this broader statutory argument below. For four reasons, this Court should address the issue now, rather than sending the case back to the Court of Appeals to consider the argument. First, it would have been futile for PG&E to raise the argument, since *Fobian* unequivocally required disallowance of Travelers' claims for attorneys' fees here for litigating pure issues of bankruptcy law—and gave unsecured creditors the right to seek attorneys' fees in most other circumstances. The Bankruptcy Court, the District Court, and the Ninth Circuit panel all lacked the authority to overrule that longstanding authority. Second, as noted above, the issue is not only fairly included in Travelers' Question Presented, but is the keystone of Travelers' brief. *See supra* at 12-13 & n.3. Third, the narrower statutory argument—about Travelers' entitlement to fees under these specific circumstances—is squarely presented and preserved, and, indeed, was addressed by the Court of Appeals. *See* PA 3a. But, as we shall see momentarily, the answer to that question depends upon, and flows from, analysis of this broader issue of statutory interpretation. Fourth, the issue, as we have shown, has fully percolated among the lower courts

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formally *assumed* a lease. When that occurs, the debtor must accept all the contract's terms, including a provision requiring reimbursement of attorneys' fees. *See* § 365(a). In fact, the Code will not allow the debtor to assume the lease *unless* the debtor "cures" any "default." § 365(b)(1)(A). A seventh case—which was uncritically adopted by most of the subsequent cases in the minority camp—was actually decided under the Bankruptcy Act, albeit too late for the Code's drafters to have known about it. *See United Merchs.*, 674 F.2d at 136-40.

for more than two decades and they are hopelessly split. *See supra* at 14-15 nn.4-5.

In sum, there is no reason to remand the case to the Court of Appeals to address this purely legal issue.[19]

II. TRAVELERS CANNOT CLAIM FEES FOR ACTIVITIES THAT WERE NOT REASONABLY NECESSARY TO PROTECT ITS RIGHTS.

Even if the Code permits unsecured creditors to recover postpetition attorneys' fees by contract, the Court of Appeals' denial of fees must still be affirmed. If there is a statutory entitlement to fees, it is subject to a reasonableness limitation. *See infra* Point II.A. All three courts below correctly found that Travelers' activities were not reasonably necessary to preserve its rights. *See infra* Point II.B. As the Court of Appeals held, and PG&E argued throughout the litigation (including in its opposition to certiorari), the Code simply does not permit "unimpaired, non-prevailing creditors ... to obtain an attorney fee award in bankruptcy for inquiring about the status of unimpaired inchoate and contingent claims," for if it did, "the system would likely be overwhelmed by fee applications, with no funds available for

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[19] *See Sure-Tan, Inc. v. NLRB*, 467 U.S. 883, 897 n.7 (1984) (considering "petitioner's presentation of their ... challenge for the first time before this Court" because an intervening decision changed the controlling law after cert. petition filed); *Kiefer-Stewart Co. v. Seagram & Sons, Inc.*, 340 U.S. 211, 214 (1951) (addressing argument raised for the first time on appeal, where "[t]hese grounds raise only issues of law not calling for an examination ... of evidence"), *overruled on other grounds by Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984); *see also Standard Indus., Inc. v. Tigrett Indus., Inc.*, 397 U.S. 586, 587-88 (1970) (Black, J., dissenting, in 4-4 split) (three factors control whether to consider issues not raised below: "first, whether there has been a material change in the law; second, whether assertion of the issue earlier would have been futile; and third, whether an important public interest is served by allowing consideration of the issue").

disbursement to impaired creditors or debtor reorganization." PA 3a.

A. Any Unsecured Creditor's Claim for Contractual Attorneys' Fees Must At Least Be Reasonable.

As we have seen, Travelers' argument that unsecured creditors can recover attorneys' fees rests on a hyper-literal reading of an ambiguous general provision that has nothing to do with fees. Since Congress did not mention attorneys' fees—and may not even have thought of attorneys' fees when it crafted § 502(b)'s general language, *see supra* at 22-23, 37-38—it omitted the customary limits on attorneys' fees.

Had Congress expected the courts to interpret the Code as Travelers urges, it would undoubtedly have insisted that any fees must be disallowed unless they were necessary to protect the creditor's rights, or at least reasonable. That is what Congress did every single time it expressly awarded attorneys' fees to a creditor. The most common basis for awarding attorneys' fees to a creditor is where the creditor has performed some important service, whether for the estate or for other creditors. *See generally* Law Profs. at 9-12. Thus, for example, a creditor can seek attorneys' fees for "recovering . . . for the benefit of the estate any property transferred or concealed by the debtor," § 503(b)(3)(B); for seeking "damages on behalf of the debtor" against a "bankruptcy petition preparer" who committed fraud, § 110(i)(2); for assisting "with the prosecution of a criminal offense relating to the case or to the business or property of the debtor," § 503(b)(3)(C); for "making a substantial contribution," in certain sorts or bankruptcy cases, § 503(b)(3)(D); or for forcing a debtor into a bankruptcy proceeding involuntarily, § 503(b)(3)(A).

In each of these circumstances, Congress strictly limited the fees. It did not simply require that the fees be

"reasonable . . . based on the time, the nature, the extent, and the value of such services, and the cost of comparable services." § 503(b)(4) (specifying fees available for attorneys performing services described in § 503(b)(3)(A)-(D)). Congress went even further and denied attorneys' fees for any activity unless the creditor could show that the activity was "necessary" to achieve the prescribed goal. *Id.* The only other circumstance where a creditor is expressly granted the right to receive attorneys' fees is in the context of § 506(b), where the fees must be "reasonable."

Expanding the focus more broadly to other circumstances where the Code allows *any party* to collect attorneys' fees from any another, the same pattern emerges. Virtually every time, the fees are subject to either the same "necessary" and "reasonable" constraint noted above, *see* §§ 503(b)(3)(E)-(F), or the fees must at least be "reasonable," §§ 303(i)(1)(B), 523(d).

Congress could not have intended to accord better treatment to unsecured creditors than to oversecured ones (who cannot seek contractual fees unless they are reasonable). Nor could Congress have intended to elevate unsecured creditors who are protecting their own interests—and even, on Traveler's theory, who deplete the estate's assets without any benefit to anyone—over creditors who take heroic measures to increase the resources available to all.

To read the Code this way would fly in the face of the axiom "'that statutes should receive a sensible construction, such as will effectuate the legislative intention, and, if possible, so as to avoid an unjust or an absurd conclusion.'" *Johnson v. United States*, 529 U.S. 694, 707 n. 9 (2000) (quoting *In re Chapman*, 166 U.S. 661, 667 (1897)). This Court has not hesitated to read a reasonableness requirement into statutes in the past, when necessary to effectuate Congress's intent—even in cases where Congress had not

signaled its intention to adopt such a limit in a dozen parallel provisions, as it did here.[20]

Indeed, in *Security Mortgage*, the case on which Travelers most heavily relies, this Court did exactly that. As we have seen, the case involved an oversecured creditor that sought to recover postpetition attorneys' fees. 278 U.S. at 152. The creditor incurred the fees in a parallel proceeding that it brought in state court after the debtor had filed its bankruptcy petition. *Id.* at 151-52. In addition to unsuccessfully resisting a general right to collect postpetition attorneys' fees on statutory grounds, *see supra* at 32-33, the bankruptcy trustee also resisted the fees on the ground that the creditor's collection action was unnecessary:

> It is asserted that the suit [by the creditor] . . . was brought, not for the purpose of collecting the debt, but solely for the purpose of enhancing [by the amount of the attorneys' fees] the amount which was obtainable

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[20] *See, e.g., Air Line Pilots Ass'n, Int'l v. O'Neill*, 499 U.S. 65, 78 (1991) (holding that statutorily authorized union representatives owe a duty of reasonableness—which is violated only if the representative's conduct "can be fairly characterized as so far outside a 'wide range of reasonableness[]' that it is wholly irrational or arbitrary"—even though the literal terms of the National Labor Relations Act impose a more rigorous duty (citation omitted)); *United States v. Witkovich*, 353 U.S. 194, 200 (1957) (reading a reasonableness limitation into a provision of the Immigration and Nationality Act that purported to permit the Attorney General to elicit all information he deemed "fit and proper" from an alien, holding that "assuredly, Congress did not authorize . . . [the Attorney General] to elicit information that could not serve as a basis for confining an alien's activities"); *Wright v. Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 462 (1937) (reading a provision of the Bankruptcy Act, which purported to give a bankrupt mortgagor a stay of all proceedings against him or his property for three years, "as meaning that the court may terminate the stay if after a reasonable time it becomes evident that there is no reasonable hope that the debtor can rehabilitate himself within the three-year period").

> without suit, through the lien upon the proceeds of the property.

278 U.S. at 159. "If this is true," the Court observed, "the statutory provision designed for the protection of the debtor was employed solely as a means of oppression." *Id.* The Court found the trustee's objection "meritorious if sustained by the facts" and ordered that "the credit for attorney's fees shall be disallowed," if the allegation proved to be truthful. *Id.*

This Court did not tether this reasonableness requirement to any explicit provision of the Act. It did not need to, presumably because it was so clear that Congress would never have authorized a creditor to recover attorneys' fees for activities that were unnecessary to collect a debt and that served no purpose other than to increase the creditor's take vis-à-vis other creditors or to waste the resources of other participants in the bankruptcy proceeding. In keeping with this principle, even courts that have concluded that unsecured creditors may collect their postpetition attorneys' fees under contract have concluded that the creditors are not "'entitled to reimbursement for [legal] services that were unnecessary or unconnected with enforcement or collection of the indebtedness.'" *United Merchs.*, 674 F.2d at 140 (quoting *In re Cont'l Vending Mach.*, 543 F.2d at 994). Even the progenitor of all the cases on which Travelers relies held that "[a] rule of reason must be observed" in order to prevent contractual attorneys' fees clauses from "becoming a tool for wasteful diversion of an estate at the hands of . . . creditors who, knowing that the estate must foot the bills, fail to exercise restraint in enforcement expenses." *Id.* at 139 (citations omitted).[21]

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[21] *See also Cable Marine v. M/V Trust Me II*, 632 F.2d 1344, 1345 (5th Cir. 1980) (invoking equitable principles in declining to award fees in the

B. All Three Courts Below Correctly Found that Travelers' Activities in the Bankruptcy Proceeding Were Not Reasonably Necessary to Preserve Its Rights.

Unlike in *Security Mortgage*, there is no need here to remand for a determination of whether Travelers' activities were reasonably necessary to protect its rights or "for the purpose of collecting the debt." *Security Mortgage*, 278 U.S. at 159. As all three courts below agreed "[n]othing in the federal bankruptcy proceedings required Travelers to satisfy any of the obligations assured by, or to make any payment with respect to, any of its surety bonds or indemnity agreement with [PG&E]." PA 2a. There simply was no debt to collect, and no right to protect, just an "unimpaired inchoate and contingent claim[]." PA 3a. Travelers has never cited a single case in which a creditor was allowed to claim naked attorneys' fees, shorn from any underlying debt. More importantly, all three courts found that the activities were all utterly unnecessary to preserve any of Travelers' contingent rights. In a lengthy exchange with Travelers counsel, the Bankruptcy Court methodically demolished every one of Travelers' arguments as to why its actions were reasonably necessary to protect its interests. *See* JA 133-134, 139, 141-43. The District Court reiterated the view that Travelers faced no threat to any of its rights. *See* PA 18a-19a. And the Court of Appeals, too, characterized Travelers as an "unimpaired, non-prevailing creditor[]," emphasizing

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face of contractual provisions awarding them); *In re Keaton*, 182 B.R. 203, 209 (Bankr. E.D. Tenn. 1995) ("[T]he bankruptcy court has an independent power to limit . . . fees to a reasonable amount."), *aff'd*, 212 B.R. 587 (E.D. Tenn. 1997), *vacated as moot*, 145 F.3d 1331 (6th Cir. 1998); *In re Huhn*, 145 B.R. 872, 875 (W.D. Mich. 1992) (bankruptcy courts are responsible for preventing the waste of estate assets by overreaching attorneys seeking fees from the estate).

that "Travelers did not prevail on any claim it asserted in the bankruptcy proceedings." PA 2a.

Travelers did not seek review of those findings before this Court. As much as it wishes to dispute these fact-bound findings with the same arguments roundly rejected below, it has waived the chance to do so now. *See Singleton v. Wulff*, 428 U.S. 106, 119 (1976).

The purpose of the reasonableness requirement is to ensure that estate assets are not squandered by creditors "exhibiting excessive caution, overzealous advocacy and hyperactive legal efforts." *In re Gwyn*, 150 B.R. 150, 155 (Bankr. M.D.N.C. 1993). There is no more apt description of Travelers' participation in this bankruptcy case—litigating over a disallowance that was statutorily mandated, *see* § 502(e)(1), only to stipulate that it was disallowed, and pressing for "comfort language" that preserved rights Travelers automatically had by statute. The Court of Appeals was correct when it worried that if every contractual creditor were to be rewarded for doing what Travelers did, "the system would likely be overwhelmed by fee applications, with no funds available for disbursement to impaired creditors or debtor reorganization." PA 3a.

III. TRAVELERS CANNOT RECOVER THE ATTORNEYS' FEES IT INCURRED IN THE BANKRUPTCY PROCEEDING BECAUSE ITS CONTRACT DOES NOT GRANT IT ANY SUCH RIGHT.

The premise of this entire appeal—incorporated directly into Travelers' Question Presented—is that "Petitioner and Respondent entered into a contract that included a provision that Petitioner is entitled to recover its attorneys' fees incurred in . . . litigating its rights during the course of Respondent's bankruptcy case." Pet. i. Only if that premise is correct could Travelers insist that it has a "claim" for

attorneys' fees, within the meaning of § 101(5), and that the claim is allowable under § 502(b). Because Travelers' premise is false, the entire conversation about statutory construction is beside the point.

As PG&E has argued throughout this litigation, the indemnity agreements do not grant Travelers a right to recover attorneys' fees it incurred to participate in a bankruptcy proceeding when its rights were not in jeopardy. The contractual language on which Travelers relies does not say (as Travelers repeatedly renders it) that "PG&E is obligated to reimburse Travelers for any and all attorneys' fees that Travelers incurs in connection with the bonds." Pet'r Br. at 6; *see, e.g., id.* at 1, 7, 9. Rather, the only provision Travelers can invoke here is the one it emphasized throughout the litigation, authorizing recovery of attorneys' fees for "*enforcing* by litigation or otherwise any of the [indemnification] agreements herein contained." SJA 9 (emphasis added).[22] Travelers was not "enforcing . . . any of

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[22] Another clause obliges PG&E to "*indemnify . . . and hold and save harmless [Travelers] against all demands, claims*, loss, costs, damages, expenses and attorneys' fees whatever and all liability therefore, sustained or incurred by [Travelers] by reason of executing" the bonds. SJA 9 (emphasis added). Travelers did not emphasize this provision below, because California law is clear that this hold-harmless obligation is triggered only when a *third party* sues Travelers in connection with the bonds. *See U.S. Fid. & Guar. Co. v. More*, 155 Cal. 415, 418 (1909) ("Clearly, this language does not import a right of recovery upon the part of a surety company for anything less than a legal liability which it may have incurred.").

Travelers is now collaterally estopped from arguing otherwise, or from arguing that PG&E "commenc[ed] litigation" against Travelers by making a valid objection. *E.g.*, Pet'r Br. at 16. Travelers lost both arguments when it sought to recover the same attorneys' fees that are at issue here, under an indemnity agreement with PG&E's parent company with a hold-harmless provision that was virtually identical to the one quoted immediately above. *See Travelers Cas. & Sur. Co. v. PG&E Corp.*, No. C-05-0594, 2005 WL 1039080 at *2-*3 (N.D. Cal. May 4,

the indemnification agreements" when it participated in the bankruptcy, because (again, as the courts below all agreed) the agreements were not breached, not in danger of being breached, and not threatened by any position PG&E took.

This Court should address this contractual issue, which PG&E has pressed throughout this litigation, even though the Court of Appeals did not address it. *See Washington v. Confederated Bands & Tribes of Yakima Indian Nation*, 439 U.S. 463, 478 (1979); *Thigpen v. Roberts*, 468 U.S. 27, 29-30 (1984). The single word that controls—"enforcing"—is, susceptible of only one reasonable interpretation. And, while not purporting to dispose of the issue of contract interpretation, all three courts below did conclude that Travelers was not enforcing anything.

CONCLUSION

For these reasons, this Court should affirm the judgment of the Court of Appeals.

Respectfully submitted,

2005). Only after the Court of Appeals issued its opinion in this case did Travelers settle the parallel case and withdraw its pending appeal, giving the ruling final and preclusive effect. *See, e.g., Semtek Int'l Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 508 (2001) (preclusive effect of a federal diversity court's judgment is determined, under federal law, by applying "the law that would be applied by state courts in the State in which the federal diversity court sits"); *Abelson v. Nat'l Union Fire Ins. Co.*, 28 Cal. App. 4th 776, 787 (1994) ("according to California law, a judgment is not final for purposes of collateral estoppel while open to direct attack, e.g., by appeal") (collecting authorities). PG&E has requested permission to lodge the stipulation of dismissal with the Clerk of the Court, pursuant to S. Ct. R. 32.3.

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STATUTORY APPENDIX

11 U.S.C. § 506(a) and (b) provide, in relevant part, as follows (with *italics* indicating a recent amendment that is inapplicable to this case):

§ 506. Determination of secured status.

(a)*(1)* An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

* * *

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement *or State statute* under which such claim arose.

* * *

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No. 05-1429

IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONER

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QUESTION PRESENTED

Whether in bankruptcy cases a litigant may recover attorneys' fees arising under a contract or state statute where the issues litigated involve matters of federal bankruptcy law.

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SUMMARY OF REPLY

Like the district and bankruptcy courts, the court of appeals resolved Travelers' claim for attorneys' fees exclusively on the basis of its *Fobian* rule: "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'" Pet. App. 3a (quoting *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991)). As demonstrated in Travelers' opening brief, the *Fobian* rule is wrong and, because the decision below is premised exclusively on *Fobian*, it must be reversed.

In each court below, PG&E argued that the *Fobian* rule disposed of Travelers' claim, and PG&E defended *Fobian*. Now, PG&E abandons *Fobian* and invites the Court to adopt a far different rule -- one that it did not raise below, that no court of appeals has ever endorsed, and that lies outside the question presented. Whereas the *Fobian* rule denies claims for attorneys' fees incurred in litigating *federal* issues as a matter of general federal common law, PG&E theorizes that, on the basis of its novel interpretation of the Bankruptcy Code, *all* unsecured claims for attorneys' fees must be denied. Not only is PG&E's theory different from the *Fobian* rule, it is at war with the rule, as PG&E's theory would deny claims for attorneys' fees that *Fobian* permits (i.e., those incurred in litigating state law issues).

Time and again, this Court has stated that it will decline to consider issues not raised or decided below, or that lie outside the question presented, and the Court should apply that prohibition here. Although PG&E's argument is meritless, demonstrating its flaws requires consideration of many arcane bankruptcy concepts. Although Travelers will explain why PG&E's argument is unsound, a full explication is beyond the capacity of a twenty-page reply brief.

In the alternative, PG&E invites the Court to create yet another rule of general federal common law to deny Travelers' claim -- that all claims for attorneys' fees in bankruptcy must be superintended by a heretofore undefined

federal test of reasonableness that Travelers somehow fails. The Court should decline to address PG&E's contention because it was not decided below and is outside the question presented. Moreover, PG&E's contention is meritless -- the standard that PG&E advances is precluded by the text of the Code, and Travelers' conduct was reasonable.

Finally, PG&E argues through selective quotation that Travelers' claim falls outside the scope of its contract. Once again, the Court should decline to address PG&E's contention because it was not decided below and is outside the question presented. In addition, PG&E's argument is meritless -- the indemnity provisions are intentionally broad and encompass any loss associated with the Bond, including Travelers' claim for attorneys' fees.

REPLY TO PG&E'S STATEMENT

PG&E contends that Travelers intervened needlessly in PG&E's bankruptcy proceeding on the theory that Travelers need have done nothing to protect its rights incident to its $100 million Bond. Not so. The whole point of a bankruptcy filing is to impair rights. *Ashton v. Cameron County Water Improvement Dist.*, 298 U.S. 513, 530 (1936) ("The especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned -- to change, modify, or impair the obligations of their contracts."). Moreover, the clear rule in chapter 11 is that a party loses its rights if it does not assert them by (1) filing a proof of claim, (2) defending litigation brought by the debtor, and (3) ensuring its proper treatment in a chapter 11 plan.

For example, if Travelers had not filed its proof of claim, PG&E would have been free to default on its workers' compensation obligations, Travelers would have been forced to pay benefits under its Bond, and Travelers would have been unable to recover *anything* in reimbursement from PG&E because its reimbursement claim would have been barred by the failure to file a proof of claim. FED. R. BANKR. P. 3002(a), 3003(b), (c)(2); *New York v. Irving Trust Co.*, 288 U.S. 329, 333 (1933); *Employee Ret. Corp. v. Osborne (In re*

THC Fin. Corp.), 686 F.2d 799, 802, 804 (9th Cir. 1982) (creditor who failed to file proof of contingent claim barred from recovery). Debtors in bankruptcy frequently default on their bonded obligations (indeed, that is the norm) and, as a result, sureties file proofs of claim at the beginning of a case (when they are required to do so) to protect their interests. *See Aetna Cas. & Sur. Co. v. Clerk of U.S. Bankr. Court (In re Chateaugay Corp.)*, 89 F.3d 942, 945-46 (2d Cir. 1996).

Likewise, if PG&E's Plan had not properly spelled out (at Travelers' insistence) the treatment of the claims of the injured workers, PG&E's obligations to the workers would have been discharged, destroying both the workers' rights to payment and the value of Travelers' subrogation rights -- Travelers' subrogation rights would be worthless if the workers themselves had no rights against PG&E owing to the discharge of their claims. 11 U.S.C. § 1141(d) (discharging all claims except those that are preserved in confirmed plan of reorganization). Further, if Travelers had done nothing to defend the litigation that PG&E commenced seeking to eliminate both Travelers' rights *and* the claims of the injured workers, PG&E would have been entitled to a default judgment securing this relief. FED. R. BANKR. P. 7055 (authorizing bankruptcy court to enter default judgments).

Moreover, Travelers never agreed that its proof of claim or other conduct was improper. Nor did any of the courts below conclude that Travelers acted unreasonably. The bankruptcy court -- the only trier of fact -- expressly ruled: "I don't need to get to the question, and I won't address the question, of whether the fees were reasonable in whole or in part." Pet. App. 25a. Nor did the bankruptcy court otherwise make *any* finding that Travelers need not have (1) filed a proof of claim, (2) objected to PG&E's plan and disclosure statement, (3) defended the litigation that PG&E commenced, or (4) taken any of the other steps that it took. On the contrary, the court stated: "As far as . . . Travelers protecting its position by negotiating with the plan and the disclosure statement, of course, you had every right to do that. . . . I just

don't think the Debtor has to pay for it, because I think it's bankruptcy law." Pet. App. 24a. PG&E never appealed the bankruptcy court's findings, and they remain undisturbed.

Further, Travelers was ultimately successful in protecting both its own rights and the rights of the injured workers. Specifically, at Travelers' insistence, the rights of the injured workers were properly classified and rendered unimpaired under PG&E's plan, and the parties eventually stipulated that Travelers' rights were preserved. For example, the Stipulation provides: "To the extent that Travelers is subrogated to the claim of any obligee under any of its Surety Bonds, Travelers shall hold such claim as a general unsecured creditor . . . ." J.A. at 108a.

PG&E describes as merely "comfort" provisions the portions of PG&E's Plan spelling out the specific treatment of Travelers' rights and the claims of the injured workers. PG&E's characterization is wrong. The provisions in the Plan *define* the rights of the parties, 11 U.S.C. § 1141(a) (the provisions of a confirmed plan bind all parties), and are items that the Bankruptcy Code itself specifically requires, 11 U.S.C. § 1123(a) (a plan "shall" specify the treatment of claims and designate whether they are impaired or unimpaired). Accordingly, PG&E's Plan was defective without them. *See* 11 U.S.C. § 1129(a)(1) (a plan cannot be confirmed if it does not comply with the Bankruptcy Code, including section 1123). Not surprisingly, the bankruptcy court directed that the provisions be included. J.A. at 45a.

PG&E asserts that the rights of the injured workers were never at risk, and cites a provision of its Plan dealing with benefit programs as "executory" contracts. J.A. 28a. But as PG&E well knows, the claims of the injured workers do not qualify as executory contracts, *see* 11 U.S.C. §§ 365 & 1123(b)(2); *In re Texscan Corp.*, 976 F.2d 1269, 1272 (9th Cir. 1992) ("[I]n executory contracts the obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other.") (marks and

citations omitted); *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673, 677 (9th Cir. 1996) ("§ 365 only allows the assumption and assignment of executory contracts"), and the provision of the Plan that PG&E cites refers to its ongoing agreements with third party benefit *administrators*, not the claims of the injured workers themselves (who had no obligations to perform to obtain their benefits). Moreover, PG&E's argument is fundamentally inconsistent with its conduct -- even though it *now* claims that the rights of the workers were never at risk, it previously sought to disallow them. J.A. 76a-80a.

PG&E suggests that it did not unilaterally modify the Negotiated Language preserving Travelers' subrogation rights. Not true. PG&E's red-lined version of its Plan clearly shows the changes that PG&E unilaterally made to the Negotiated Language. The Negotiated Language provided: "The subrogation rights of any surety, to the extent applicable or available, shall be unaffected by the Plan and, if available or applicable, remain in full force and effect." PG&E unilaterally changed this to "[n]othing in the Plan shall (a) affect the subrogation rights of any surety, to the extent applicable or available, which, if available or applicable, shall remain in full force and effect; or (b) the rights of the Debtor to object, pursuant to the Bankruptcy Code, to the existence of such subrogation rights." J.A. at 56a. PG&E then commenced litigation against Travelers by filing its objection and asking for affirmative relief. *See* FED. R. BANKR. P. 3007, 7001. Among other things, PG&E improperly characterized Travelers' subrogation rights as "claims," sought to eliminate them as "not valid," and attempted to "subordinate" Travelers' "claims." J.A. at 73a-74a, 80a. As noted, PG&E also sought to eliminate the claims of the injured workers. J.A. at 76a-80a. Not surprisingly, Travelers responded.

The record demonstrates that Travelers acted prudently to protect its rights (as well as those of the injured employees), and that it was *PG&E* that crafted a defective Plan and

pursued litigation needlessly against Travelers. As PG&E concedes, Travelers' proof of claim "did not assert that PG&E owed Travelers any money" for paying any benefits under its Bond. Resp. Br. at 3. As PG&E also concedes, Travelers merely asserted in its proof of claim that it had certain rights to payment against PG&E in the event it must ever make payment under its Bond, and that all that Travelers was attempting to do was protect its rights. *Id.* Given that Travelers was not seeking to collect money that PG&E did not owe, but was simply seeking to protect its rights, *it is PG&E, not Travelers, that need have done nothing.* PG&E never explains why it commenced litigation objecting to Travelers' rights and seeking to eliminate the claims of the injured workers. The answer is simple: like debtors generally in bankruptcy, PG&E objected to virtually *every* claim because it hoped to reduce its liabilities. Like other creditors, Travelers responded to protect its rights.

Finally, there is nothing mysterious (or nefarious) about the fact that Travelers may recover its attorneys' fees from PG&E incurred in protecting its rights even though Travelers has not paid anything on its Bond. Sureties routinely incur attorneys' fees in setting up and administering complex bond programs for corporations such as PG&E, and corporations such as PG&E are routinely responsible for paying the surety's attorneys' fees even though the surety has not made (and may never have to make) any payment under its bonds. That is the nature of the parties' bargain, and PG&E cannot claim successfully that it is at all unusual or contrary to legitimate commercial practice.

ARGUMENT

A. PG&E's Novel Interpretation Of The Bankruptcy Code Is Unsuitable For Review and Without Merit.

In its opening brief, Travelers demonstrated that it holds a "claim" for its attorneys' fees. Travelers also demonstrated that its claim for attorneys' fees should have been allowed under section 502. Section 502(b) directs that a claim must be allowed, unless one of the enumerated grounds for

disallowance applies. Because none of the grounds for disallowance applies, section 502 requires allowance.

The courts below denied Travelers' claim for one reason only -- the *Fobian* rule. In its opening brief, Travelers demonstrated that the *Fobian* rule is unsound. Critically, PG&E does not disagree. Because the *Fobian* rule is invalid, this Court should reverse and decline to address PG&E's alternative theory.

1. The Court Should Not Consider PG&E's Theory.

Abandoning *Fobian*, PG&E contends that, on the basis of its novel interpretation of the Bankruptcy Code, *all* unsecured claims for attorneys' fees based on pre-petition contractual or statutory entitlements must be denied, regardless of whether the fees were incurred in litigating state or federal issues. PG&E failed to raise this theory below or in its opposition to Travelers' petition for certiorari. Further, PG&E's theory lies outside the question presented, which involves exclusively the legitimacy of the *Fobian* rule.

The Court has stated repeatedly that it "is a court of review, and it will not consider questions not raised or disclosed by the record brought to it for a review and which were not considered by the courts below." *Edward Hines Yellow Pine Trustees v. Martin*, 268 U.S. 458, 465 (1925); *see also Clingman v. Beaver*, 544 U.S. 581, 597-98 (2005); *Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 168-69 (2004). In addition, "we continue to strongly 'disapprove the practice of smuggling additional questions into a case after we grant certiorari.'" *Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Corp.*, 510 U.S. 27, 34 (1993) (citation omitted); *see also* SUP. CT. R. 14.1(a) ("Only the questions set out in the petition, or fairly included therein, will be considered by the Court."); *Glover v. United States*, 531 U.S. 198, 205 (2001); *Roberts v. Galen of Virginia, Inc.*, 525 U.S. 249, 253-54 (1999).

Given Rule 14.1(a) and the Court's often-repeated admonitions, it was entirely inappropriate for PG&E and its *amici* to raise their novel theory for the first time in their

briefs on the merits (and devote almost their entire eighty pages of briefing to it), subject only to a twenty-page reply from Travelers. PG&E's tactic is particularly burdensome because no court of appeals has ever endorsed PG&E's theory, and there has been no development of the theory through meaningful appellate review. Further, review of the theory necessarily involves consideration of numerous arcane provisions of the Bankruptcy Code not implicated by the question presented. Nor does PG&E present any persuasive reason for being excused from failing to raise its theory earlier. Travelers challenged the legitimacy of the *Fobian* rule in each court below (as well as in its petition for certiorari), and PG&E had ample opportunity to raise its theory, but chose not to. PG&E should not be permitted to burden the Court with what amounts to litigation by ambush.

2. PG&E's Argument Is Contrary To The Code, and Foreclosed Because PG&E Is Solvent.

PG&E's novel argument is also without merit. Although PG&E sometimes characterizes Travelers' right to payment of its attorneys' fees as a post-petition "administrative expense" rather than a "claim," Resp. Br. at 27, PG&E concedes that the definition of claim "appears" to include a pre-petition contractual right to attorneys' fees, even though the fees are incurred after the debtor files for bankruptcy. Resp. Br. at 15. From there, however, PG&E abandons what the Code actually says in favor of a speculative guessing game about what Congress might have thought about pre-petition contractual rights to attorneys' fees that are not yet incurred at the time the debtor files for bankruptcy. PG&E's speculation is foreclosed by what Congress actually drafted, and likewise by the fact that PG&E is a solvent debtor.

First, PG&E confuses the difference between "claims" and "administrative expenses," and what rights to payment properly constitute "claims." In determining whether Travelers' holds a claim, it does not matter that Travelers incurred its attorneys' fees post-petition after PG&E filed for bankruptcy. What matters is that Travelers' right to payment

arises from its pre-petition contract because the definition of "claim" specifically includes a right to payment that is "contingent," "unmatured," or "unliquidated" at the time the debtor files for bankruptcy. *See In re Bayly Corp.*, 163 F.3d 1205, 1208-09 (10th Cir. 1998) ("If a debtor becomes liable to a claimant before the bankruptcy petition is filed, but the liability is contingent on the occurrence of some future event, the claim to recover that debt is treated as a pre-petition claim even if the condition does not occur and the right to payment does not arise until after the bankruptcy petition is filed."); *In re Fostvedt*, 823 F.2d 305, 306-07 (9th Cir. 1987).

At the time PG&E filed for bankruptcy, Travelers held a contractual right to payment of its attorneys' fees, but had not yet incurred the fees. Travelers incurred the fees after PG&E filed for bankruptcy, and PG&E's liability became "fixed" when the fees were incurred. But PG&E's liability still arises from its pre-petition contract -- there is no other basis for the liability. Accordingly, Travelers' right to payment is properly a "claim" within the meaning of section 101(5). *In re Kadjevich*, 220 F.3d 1016, 1020 (9th Cir. 2000) (post-petition attorneys' fees on pre-petition obligation held to be general unsecured claim); 5 COLLIER ON BANKRUPTCY ¶ 553.03[1][i] at 553-20 - 21 (15th ed. rev. 2004) ("In general, if the creditor incurs the attorneys' fees postpetition in connection with exercising or protecting a prepetition claim that included a right to recover attorneys' fees, the fees will be prepetition in nature, constituting a contingent prepetition obligation that became fixed postpetition when the fees were incurred.").

It cannot be otherwise. If obligations arising from pre-petition contracts that become fixed after the debtor files for bankruptcy were not "claims," then they would not be cognizable (or dischargeable) in bankruptcy at all. *See Ohio v. Kovacs*, 469 U.S. 274, 286 (1985) (O'Connor, J., concurring) (making this observation). They would not be administrative expenses. Administrative expenses are post-petition obligations of the *bankruptcy estate* under section

503 of the Bankruptcy Code, such as obligations arising from purely post-petition contracts or services provided to the estate. 11 U.S.C. § 503; *In re Kadjevich*, 220 F.3d at 1019-20 (discussing administrative expenses); *In re Abercrombie*, 139 F.3d 755, 756-78 (9th Cir. 1998) (same). Travelers' right to payment of its fees is squarely a "claim."[1]

Second, PG&E's theory attempts to engraft onto section 502 restrictions that Congress has rejected. Congress chose to exclude from the concept of an "allowed claim" only one type of right to payment of attorneys' fees -- those of the debtor's attorney, and only to the extent that the fees exceed the reasonable value of the attorneys' services (e.g., a contingency fee arising from pre-petition services fixed by a

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[1] For example, suppose PG&E guaranteed a $100 million debt that its corporate parent ("Parent") owed to a bank ("Bank"). Suppose that, at the time PG&E filed for bankruptcy, the Parent had not yet defaulted on the $100 million obligation to the Bank and, thus, PG&E owed nothing on its guaranty at that time. Nevertheless, the Bank would hold a "claim" against PG&E on the guaranty even though PG&E's liability at the time of its bankruptcy filing was "contingent" upon the Parent's future default. Suppose further that, after PG&E filed for bankruptcy, the Parent then defaulted on the $100 million obligation. PG&E's liability would no longer be "contingent;" it would be "fixed" by the Parent's default. PG&E's guaranty liability, however, would still constitute a claim even though it became "fixed" post-petition. *See In re All Media Properties, Inc.*, 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980) (discussing the "classic contingent liability of a guarantor [of a note where] both the creditor and guarantor knew there would be liability only if the principal maker defaulted."), *aff'd*, 646 F.2d 193 (5th Cir. 1981). If amounts arising from pre-petition contracts that become fixed after a debtor files for bankruptcy were not claims, a debtor with contingent guaranty obligations could file for bankruptcy and pay nothing on its guaranty obligations simply by virtue of the fact that they had not yet become fixed. The law prescribes otherwise.

post-petition judgment). 11 U.S.C. § 502(b)(4). Had Congress intended to exclude any other right to payment of attorneys' fees from an allowed unsecured claim, Congress would have done so in section 502. For example, by analogy, Congress expressly excluded from an allowed unsecured claim any pre-petition contractual right to *interest* incurred post-petition. 11 U.S.C. § 502(b)(2); *United Sav. Assoc. of Texas v. Timbers of Inwood Forest*, 484 U.S. 365, 372-73 (1988) (section 502(b)(2) is the "general rule disallowing postpetition interest"). Congress chose not to do the same for post-petition *attorneys' fees*, and the courts should not engraft onto the text what Congress omitted. That is especially so because Congress considered *and rejected* what PG&E wishes to add to the text. *See* S. 1301, 165th Cong., § 203 (June 4, 1998) (failed amendment that "a creditor may not charge a debtor, or the account of a debtor, for attorneys' fees or costs for work performed in connection with a case brought under this title.").

Third, although PG&E classifies Travelers' claim for its attorneys' fees as a "contingent" claim, it concedes that the contingent nature of a claim is not grounds for disallowance. 11 U.S.C. § 502(b)(1). Indeed, regardless of whether Travelers' claim for its fees is classified as "contingent," "unliquidated," or "unmatured," *none* of these characteristics are, by themselves, grounds for disallowance.

Fourth, the fact that section 502 provides that the court shall determine a claim "as of the date of the filing of the petition" does not render section 502 ambiguous or somehow preclude the allowance of Travelers' claim. The phrase "as of the date of the petition" simply marks the boundary between pre-petition "claims" and post-petition expenses of administration. The boundary is significant because, generally speaking, administrative expenses are entitled to priority over claims. *See* 11 U.S.C. § 507(a)(2).

Fifth, PG&E's reference to the estimation procedures of section 502(c) is equally unavailing. Section 502(c) simply provides that "[t]here shall be estimated for purpose of

allowance under this section . . . any contingent or unliquidated claim, the fixing or liquidation of which would unduly delay the administration of the case." 11 U.S.C. § 502(c). The key phrase is "unduly delay." To the extent that a claim for fees can be determined during the course of the debtor's bankruptcy case -- for example, the relevant fees are incurred in litigating issues during the course of the case -- the claim should be allowed in the amount incurred. To the extent that the claim for fees cannot be determined during the course of the case -- for example, the fees will continue to be incurred after the debtor's bankruptcy case is over -- the fees should be estimated and allowed in the estimated amount. Section 502(c) is simply an administrative mechanism to facilitate the closing of bankruptcy cases.

Sixth, PG&E misconstrues section 506. By its terms, section 506 (captioned "Determination of secured status") prescribes only when a particular right to payment is given *secured* status and, therefore, afforded priority over unsecured claims and administrative expenses. *See* 11 U.S.C. §§ 725, 1129(b)(2); *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 238-39 (1989) ("Section 506 . . . governs the definition and treatment of secured claims."). But Travelers does not contend that its claim is secured; it contends that its claim is *un*secured. Accordingly, section 506 does not apply. Moreover, reference to section 506 in context with section 502 only confirms that there is no basis in *either* section for disallowing Travelers' right to payment of its attorneys' fees as an unsecured claim.

The mechanics of section 506 are straightforward. To begin with, section 506(a) provides that a claim that is secured by a lien on property of the bankruptcy estate is a "secured" claim to the extent of the *value* of the property securing the claim. In other words, section 506(a) gives a claim secured status to the extent of the value of the collateral. The balance of the claim not covered by the value of the collateral (the "deficiency") is treated as an unsecured claim. *Ron Pair*, 489 U.S. at 239 ("Subsection (a) of § 506

provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured.").

Next, section 506(b) prioritizes the elements of the secured claim by adding post-petition interest and attorneys' fees to the pre-petition amount of the claim to the extent that the value of the collateral is sufficient to cover *both* the pre-petition amount and the post-petition interest and fees -- in bankruptcy parlance, the claim is "over-secured." *Ron Pair*, 489 U.S. at 239 ("Subsection (b) is concerned specifically with oversecured claims, that is, any claim that is for an amount less than the value of the property securing it. . . . Section 506(b) allows a holder of an oversecured claim to recover, in addition to the prepetition amount of the claim [post-petition interest and attorneys' fees]").

Critically, section 506(b) does not say *anything* about whether post-petition interest or attorneys' fees may constitute an *un*secured claim under section 502. This is not surprising because that is the province of section 502. Moreover, construing section 506(b) to disallow post-petition interest or attorneys' fees from an unsecured claim would render superfluous critical provisions of section 502.

For example, as noted, section 502(b)(2) disallows from an *un*secured claim any post-petition *interest*. The fact that section 506(b) permits *adding* post-petition interest to an over-secured claim cannot be construed to mean that, by implication, section 506(b) *subtracts* post-petition interest from an *un*secured claim because doing so would render superfluous section 502(b)(2).

Further, the reason why section 506(b) prioritizes the elements of a secured claim is straightforward. Section 506(b) incorporates the pre-petition amount *first* to prevent lenders from front-loading their secured claims with post-petition interest. As noted, any amount of a claim not covered by the value of the collateral securing it is treated as an unsecured "deficiency" claim. If secured lenders could front-load their post-petition interest in their secured claims,

they could allocate pre-petition amounts to their unsecured deficiency claims to avoid section 502(b)(2). *See Sexton v. Dreyfuss*, 219 U.S. 339 (1911).

PG&E contends that its reading of section 506(b) as a general disallowance provision applicable to unsecured claims is confirmed by *Timbers*. Not so. In *Timbers*, the Court noted the interplay between sections 506(b) and 502(b)(2). 484 U.S. at 365. Critically, the Court explained that a creditor who is not entitled to post-petition interest as part of its secured claim is denied its claim for post-petition interest as part of its *un*secured claim *not* by section 506(b), *but by section 502(b)(2)*. *Id.*, at 372-73. This establishes that section 506(b) does not disallow post-petition interest from unsecured claims. *A fortiori*, section 506(b) does not disallow attorneys' fees from unsecured claims either.

Congress knew all about pre-petition contractual rights to post-petition attorneys' fees when it drafted the Code (e.g., section 506(b)). Congress also knew that pre- and post-petition attorneys' fees would be allowed as part of a creditor's unsecured claim under section 502 (e.g., section 502(b)(4)). Had Congress intended to disallow all post-petition *attorneys' fees* from an allowed *un*secured claim, Congress would have added such a prohibition in section 502 just as it did for post-petition *interest*.

PG&E contends that section 506 is a blanket disallowance provision applicable to both secured and unsecured claims because, if Congress adds some item to secured claims under section 506, it must, *a fortiori*, intend the obverse -- to deny the same item to unsecured claims under section 502. Resp. Br. at 18. Critically, PG&E's theory -- that an "allowed claim" cannot include any interest or attorneys' fees because these are added to an allowed secured claim by section 506(b) -- cannot be right because it would also require the disallowance of *pre*-petition interest and attorneys' fees from unsecured claims (section 506(b) does not specify that it applies only to "post-petition" interest and attorneys' fees) -- a result at war with over a century of

established bankruptcy law, including *Cohen v. De La Cruz*, 523 U.S. 213, 223 (1998) and *Ron Pair*. *See also Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163-64 (1946) (prohibition on interest applies to post-petition interest, and explaining practice that section 506(b) codifies).

PG&E counters that reading section 502 to allow post-petition attorneys' fees as part of an unsecured claim would render section 506(b) superfluous on the theory that, if pre-petition contractual rights to post-petition attorneys' fees may be part of a creditor's allowed claim under section 502, then they would already be included as part of a secured claim under section 506(a). Resp. Br. at 18, 24-25. Not so. As noted, section 506(b) *prioritizes* the elements of a secured claim, providing that that post-petition interest and attorneys' fees are to be treated as secured only if there is already enough value in the collateral to cover the pre-petition amount of the claim. *Ron Pair*, 489 U.S. at 238-40.

PG&E insists that Congress's use of the phrase "such claim" in section 506(b) refers to the underlying "allowed claim," therefore demonstrating that post-petition attorneys' fees cannot be included as part of a creditor's unsecured allowed claim because then they would already be part of a secured creditor's claim without section 506(b). But the Court has already resolved this interpretive issue by concluding that "'[s]uch claim' refers to an oversecured claim" just as Travelers has described it. *Ron Pair*, 489 U.S. at 241. As the Court's clarification reveals, the text and context of sections 506(a) and (b) demonstrate their operation with sufficient certainty to avoid ambiguity.

PG&E contends that claims for attorneys' fees should not be included as allowed claims within the scope of section 502 because section 502 does not specifically mention claims for attorneys' fees, whereas section 506(b) does. Resp. Br. at 18-19. PG&E, however, overlooks section 502(b)(4) (addressing attorneys' fees), and likewise mistakes the operational differences between the section 502 and 506(b). Section 502 deals with claims generally, and directs that all

pre-petition rights to payment are to be allowed, *except* those that are specifically excluded. In contrast, section 506(b) deals with secured claims, and directs and prioritizes the inclusion of items as part of a secured claim.

Similarly, PG&E asserts that, apart from section 506(b), when Congress intends to allow the payment of attorneys' fees, it says so expressly. Resp. Br. at 19. PG&E's catalogue of examples, however, all involve the inclusion of attorneys' fees as *priority* administrative expenses under section 503(b), *see id.* at 43, rather than as general unsecured claims under section 502. *See* 11 U.S.C. § 507(a)(2) (prescribing priority for expenses under section 503(b)). As with section 506(b), it is not surprising that, when Congress intends to give claims for attorneys' fees *priority* status, it does so by specific inclusion, but in section 502 has left the allowance of general unsecured claims to general principles (given that the category of general unsecured claims is a catch-all concept).

Finally, PG&E's theory is foreclosed because PG&E was and is a fully *solvent* debtor. As the Court observed in *Timbers*, unsecured creditors of *solvent* debtors are entitled to post-petition interest. 484 U.S. at 365. Likewise, unsecured creditors of *solvent* debtors are entitled to post-petition attorneys' fees under contracts valid under state law. *In re Dow Corning Corp.*, 456 F.3d 668, 683 (6th Cir. 2006).

3. Considerations Of Policy And History Do Not Support PG&E's Interpretation.

PG&E contends that the Court should deny all claims for post-petition attorneys' fees on the ground that allowing them would "bloat" a creditor's recovery. The theory appears to be that permitting creditors to add their post-petition fees to their claim would create an incentive to hire attorneys, litigate every issue, and then seek recovery from the debtor's estate. PG&E's argument, however, is belied by its own concessions, as well as the reality of bankruptcy recoveries: in the typical bankruptcy case: unsecured creditors recover approximately six per cent of their claims in chapter 13, seventeen percent in chapter 11, and less than one percent in

chapter 7. *See* Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results Of A Study And Analysis Of The Law*, 97 COM. L.J. 297, 322-23 (1992); Michelle J. White, *Personal Bankruptcies Under The 1978 Bankruptcy Code: An Economic Analysis*, 63 IND. L.J. 1, 39 (1987/1988). It defies credulity that, given this reality, creditors would race to hire attorneys to "bloat" their claims, only to recover a fraction of their post-petition outlays.

Moreover, as PG&E concedes, over-secured creditors are entitled to collect their contractual pre-petition claims for attorneys' fees in full. Yet, when they do, this somehow poses no problem for the bankruptcy system, or challenges its essential policies. The parade of horribles that PG&E's *amici* presents also fails. The majority of circuits to have addressed the issue allow attorneys' fees to be added to unsecured claims without triggering the disaster *amici* envision. Moreover, under the *Fobian* rule, attorneys' fees have been allowed for litigating state law issues without precipitating a crisis. But even if PG&E's (and it's *amici's*) policy concerns had merit (which they do not), they offer no basis for ignoring the plain text of the Bankruptcy Code.

Similarly, contrary to PG&E's assertion, Travelers' claim is not tantamount to an "administrative expense" any more than an over-secured creditor's claim to its post-petition fees is an administrative expense. Resp. Br. at 27. Travelers seeks to recover its attorneys' fees as part of its unsecured claim under section 502. Thus PG&E's reference to "benefit to the estate" -- which is a requirement of an administrative expense, but not a claim -- is irrelevant. *See In re Abercrombie*, 139 F.3d 755, 757 (9th Cir. 1998) (listing requirements for administrative expenses under section 503).

PG&E's historical arguments are similarly unpersuasive. As Travelers demonstrated in its opening brief, and PG&E concedes, the statutory framework has changed completely since 1903 when this Court decided *Randolph & Randolph v. Scruggs*, 190 U.S. 149 (1903) -- a case that is irrelevant as involving an administrative expense obligation rather than a

general unsecured claim. The Bankruptcy Code's concept of both a "claim" and an "allowable claim" are far broader than similar concepts under its statutory predecessors. As the Court cautioned in *Ron Pair* in construing section 506(b), "it is worth recalling that Congress worked on the formulation of the Code for nearly a decade" and that "it was intended to modernize the bankruptcy laws, . . . and as a result made significant changes in both the substantive and procedural laws of bankruptcy." 489 U.S. at 240. That observation applies here. Section 502 should be construed as it is written to permit the allowance of pre-petition contractual claims for post-petition attorneys' fees -- which, as demonstrated in Travelers' brief, is fully consistent with practice under the immediate predecessor to section 502: section 63 of the former Bankruptcy Act, as amended in 1938.

B. PG&E's Reasonableness Argument Fails.

1. The Court Should Decline To Address It.

PG&E also urges the Court to recognize as a new rule of general federal common law that all claims for attorneys' fees in bankruptcy must pass an undefined federal test of reasonableness that Travelers somehow fails. The Court should decline to address PG&E's argument because the courts below refused to address it, and the issue lies outside the scope of the question presented.

2. PG&E's Argument Is Foreclosed By The Code.

PG&E's reasonableness argument is also without merit, and is foreclosed by the Bankruptcy Code. As PG&E concedes, Congress imposed an express federal requirement of reasonableness in section 506(b) before post-petition attorneys' fees may be added to a secured claim. 11 U.S.C. § 506(b); *Ron Pair*, 489 U.S. at 241 ("Recovery of fees [under section 506(b)] . . . is allowed only if they are reasonable."). In contrast, Congress imposed no similar federal restriction on the allowance of claims for fees under section 502 (other than in section 502(b)(4)). This was deliberate. For purposes of section 502, Congress incorporated whatever standard of reasonableness exists

under *state* law. Specifically, section 502(a)(1) provides that a claim shall be disallowed to the extent that "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law . . . ." 11 U.S.C. § 502(b)(1). Under this provision, if a claim for attorneys' fees is unenforceable as "unreasonable" under applicable state law, it is unenforceable under section 502.

It is hardly surprising that Congress would impose its own federal reasonableness requirement on the elements of a claim entitled to priority under section 506(b), but not a general unsecured claim. Priority claims are paid ahead of all others, and Congress has chosen to limit priority entitlements as it sees fit. For example, some States allow lenders to collect a flat fee (e.g., a percentage of the amount of the loan) to cover their collection costs in the event of default. Congress has elected to screen these types of arrangements for reasonableness before they can be added to a priority secured claim. *See, e.g., Welzel v. Advocate Realty Invs., LLC (In re Welzel)*, 275 F.3d 1308, 1311 (11th Cir. 2001) (en banc) (fifteen percent of loan balance). Not so with regard to general unsecured claims, which are entitled to *no* priority. Consistent with the general policy that the substance of a claim is properly defined in the first instance by reference to state law, it is not surprising that Congress crafted the requirements of section 502 on much more of a "come as you are" basis. PG&E's contrary argument fails. *See, e.g., Welzel,* 275 F.3d at 1316-18 (fees excluded from section 506(b) are allowable under section 502); *In the Matter of 268 Ltd.*, 789 F.2d 674, 678 (9th Cir. 1986) (same).

3. Travelers' Conduct Was Reasonable.

As explained, Travelers acted reasonably in successfully protecting its rights and those of the injured workers, and it was PG&E that acted unreasonably in, among other things, unilaterally reneging on the Negotiated Language and commencing needless litigation against Travelers. Travelers has sustained a loss in the form of its fees in protecting its interests, and PG&E is liable for the same.

C. PG&E's Contract Theory Fails.

1. The Court Should Decline To Address It.

PG&E contends that Travelers' claim is not covered by one selected portion of the Indemnity Agreements. The Court should decline to address PG&E's assertion because PG&E failed to present it the court of appeals and, hence, the court of appeals had no opportunity to address it. Further, the issue lies outside the question presented because it has nothing to do with the merits of the *Fobian* rule.

2. PG&E's Argument Is Without Merit.

PG&E's argument is also without merit. PG&E cannot selectively redact the Indemnity Agreements to a single line, and then argue successfully that Travelers' claim falls outside that single line. The Indemnity Agreements require PG&E to make Travelers whole from *any loss of any kind* associated with the bonds that Travelers' issued on PG&E's behalf, including any incurrence of attorneys' fees.

More important, none of the courts below interpreted the Indemnity Agreements (which are to be construed in accordance with state law), leaving nothing for this Court to review. Although Travelers believes that it is entitled to prevail under the clear provisions of the agreements, if a court were to find that the agreements are in any relevant sense ambiguous, further proceedings would be required, and additional evidence potentially considered.[2]

CONCLUSION

The Court should reverse the decision below.

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[2] PG&E's preclusion argument, Resp. Br. 49-50 n.22, should not be considered, and is without merit. Among other reasons, PG&E could have, but failed to raise it in its opposition to the petition. Further, collateral estoppel does not apply because the *guaranty* contract in the other litigation contains very different provisions from the "all loss" provisions of the Indemnity Agreements. *People v. Garcia*, 141 P.3d 197, 210 (Cal. 2006).

Respectfully submitted,

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IN THE

Supreme Court of the United States

TRAVELERS CASUALTY & SURETY COMPANY OF AMERICA,

Petitioner,

—v.—

PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN SUPPORT OF RESPONDENT FOR *AMICI CURIAE* PROFESSORS RICHARD AARON, JAGDEEP S. BHANDARI, SUSAN BLOCK-LIEB, RALPH BRUBAKER, ERWIN CHEMERINSKY, S. ELIZABETH GIBSON, KENNETH N. KLEE, ROBERT M. LAWLESS, NANCY B. RAPOPORT AND ETTIE WARD

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INTEREST OF *AMICI CURIAE*[1]

The *Amici Curiae* are law professors who have devoted their careers to the study and teaching of bankruptcy law.[2] They respectfully submit this *pro bono* brief in support of Respondent.

The *Amici* are deeply interested in this case because of the severe adverse impact the allowance of postpetition legal fees to unsecured creditors in a bankruptcy case could have on the sound and economical administration of the case. They file this brief to offer to the Court what assistance they can as it considers and decides whether to allow an unsecured creditor, based on a contract clause it obtained from the debtor before the bankruptcy filing, to charge the debtor estate for the legal fees it incurs for its attorney to monitor and appear in proceedings in the debtor's bankruptcy case for the sole benefit of such creditor.

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[1] Pursuant to Rule 37 of the Rules of this Court, the *Amici* file this brief with the written consent of both parties, which are on file with the Clerk. No counsel for a party authored this brief in whole or in part. No person or entity including the *Amici* or their counsel made a monetary contribution for the preparation or submission of this brief.

[2] The *Amici* are Richard Aaron, Professor of Law, S. J. Quinney College of Law, University of Utah; Jagdeep S. Bhandari, Professor of Law, Florida Coastal School of Law; Susan Block-Lieb, Professor of Law, Fordham Law School; Ralph Brubaker, Professor of Law and Mildred Van Voorhis Jones Faculty Scholar, University of Illinois College of Law; Erwin Chemerinsky, Alston & Bird Professor of Law and Political Science, Duke University; S. Elizabeth Gibson, Burton Craige Professor of Law, University of North Carolina at Chapel Hill; Kenneth N. Klee, Professor of Law, University of California at Los Angeles School of Law; Robert M. Lawless, Gordon & Silver, Ltd. Professor of Law, William S. Boyd School of Law, University of Nevada, Las Vegas; Nancy B. Rapoport, Professor of Law, University of Houston Law Center; and Ettie Ward, Professor of Law, St. John's University School of Law.

In the *Amici's* view, an unsecured creditor who has provided no benefit to the estate should not be permitted to shift its postpetition legal fees to all of the other creditors who enjoyed no benefit from the legal services such creditor chose to obtain for its own purposes. This brief argues that, in the absence of benefit to the estate, the allowance of such fees would be at odds with long-standing precedent of this Court and the fundamental bankruptcy goal of equality for creditors, and impair the sound administration of chapter 11 and chapter 13 cases.

SUMMARY OF ARGUMENT

The *Amici* seek an affirmance of the order of the Court of Appeals for the Ninth Circuit disallowing Petitioner's claim for the legal fees it incurred for monitoring and appearing in various proceedings in the Respondent's case for reorganization under chapter 11 of the Bankruptcy Code.[3] But the *Amici* urge disallowance on a *different* basis than the one employed by that court. In this case, the Ninth Circuit applied its decision in *In re Fobian*, 951 F.2d 1149 (9th Cir. 1991), which disallowed an unsecured creditor's claim for postpetition legal fees because its fees were incurred for litigating purely *bankruptcy* law issues. The *Amici* contend, however, that *none* of the postpetition legal fees incurred by an unsecured creditor should be allowed in the absence of a substantial benefit to the estate as a result of such legal services.

The *Amici* note a long-standing holding of this Court that an unsecured creditor's postpetition legal fees are allowed only for services that provide a benefit to the estate. *Randolph v. Scruggs*, 190 U.S. 533, 539 (1903) (per Holmes,

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[3] The Bankruptcy Code is codified in 11 U.S.C §101 et seq., and is referred to herein as the Bankruptcy Code.

J.) (a claimant's pre-bankruptcy contract claim for postpetition legal services will be allowed only if they were "beneficial to the estate."). The *Amici* accordingly argue that § 502(b)[4] should be narrowly construed not to allow an unsecured creditor's claim for legal services that did not benefit the debtor estate.

This is a case in which one unsecured creditor seeks to gain more on its claim in the bankruptcy than the other unsecured creditors by collecting its own postpetition legal fees from the debtor estate.[5] The charging of an unsecured creditor's legal fees to the estate, which received no benefit from the legal services, would, however, be at odds with the bankruptcy principle of equality for creditors. The allowance of such fees to an unsecured creditor who obtained a fee-shifting contract clause would prefer such claimant over other unsecured creditors, particularly those who become creditors *involuntarily*, such as tort creditors, the United States as the holder of various non-priority tax claims, and state and local tax creditors, who were never in a position to seek fee-shifting contracts. In addition, many trade creditors and others do not have the negotiating power to obtain such

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[4] Citations in this form are to sections of the Bankruptcy Code.

[5] As stated in *In re Omigas Group, Inc.*, 16 F.3d 1443, 1445 (6th Cir. 1994), analogizing to the film, Annie Hall (United Artists Entertainment 1977):

> Understandably, creditors of bankrupt debtors often feel like restaurant patrons who not only hate the food, but think the portions are too small. [fn 1]. To press the analogy, they also don't like having to wait in line for a table, possibly being seated only to find out that the kitchen has just closed. The bankruptcy court is a little like a soup kitchen, ladling out whatever is available in ratable portions to those standing in line; nevertheless, scarcity begets innovation in the hungry creditor's quest to get a little more than the next fellow. This case involves just such an effort.

clauses, so that an unsecured creditor who obtained such a clause would be preferred over many other types of creditors as well.

The bankruptcy system would be overwhelmed with claims by unsecured creditors for legal fees if they are allowed to charge the estate for the fees of their attorneys to monitor all of the proceedings in the bankruptcy case, and to pursue unnecessary protections for their claims in proceedings in the case. The announcement of such a rule would be a wake-up call to creditors alerting them to write or revise their contract forms so as to shift to the estate all legal fees they may incur for services that relate in *any* way to a subsequent bankruptcy case of the other party. Such a rule could generate a multitude of legal fee claims by unsecured creditors in many bankruptcy cases, which would be duplicative of the legal fees borne by the estate for the services of the attorney for the statutorily designated official creditors' committee, which performs its statutory duties and functions on behalf of the entire creditor body.

Moreover, a ruling that allows postpetition legal fees for services to an unsecured creditor that did not benefit the estate would cause severe adverse consequences in chapter 11 and chapter 13 cases. In light of the consequences of such a rule, as set forth herein, Congress could not have intended to obscure the allowance of such legal fee claims within the general language of § 502(b).

First, if the Court announces such a rule, it will alert all creditors to write broad fee shifting clauses, and the level of participation by unsecured creditors' attorneys will increase because the estate will bear the freight. Unsecured creditors' attorneys will monitor all proceedings in chapter 11 cases even though many, if not most, of them do not directly affect the particular rights of their creditor clients.

Second, allowing postpetition legal fees to an unsecured creditor will overly complicate chapter 11 cases. At the beginning of a chapter 11 case, the creditor would not know what legal services it will seek or the extent thereof. That will only become known in stages as the chapter 11 case progresses. Nevertheless, at the outset of a case, as in the present one, the creditor will file a "contingent" proof of claim in a particular amount, based solely on a guess. In due course, it will be necessary to quantify the claim, either by estimation pursuant to § 502(c), or by an adjudication in a litigated proceeding. Neither process, however is satisfactory. An estimation proceeding is a process leading to an educated guess by the bankruptcy court, which may turn out to be way off the mark, and the litigated approach may require more than one adjudication to determine the amount of the creditor's claim. This will consume the time of the court and the parties, and escalate the burden on the estate for fees, while reducing the "pot" available for the other unsecured creditors.

Third, the allowance of postpetition legal fee claims of unsecured creditors would have a significant adverse effect both on chapter 13 debtors and their unsecured creditors. This is of great concern because of the hundreds of thousands of chapter 13 cases filed each year. These adverse effects have come into sharp focus because of amendments to the Bankruptcy Code governing chapter 7 and chapter 13 adopted by Congress in 2005. The vast majority of workers use their own automobiles to get to and from their jobs. Under the amended provisions, for most chapter 13 debtors to avoid foreclosure of the purchase money lien on their cars and be able to retain them and enjoy a "fresh start," they must pay in cash to the secured party the full amount of the underlying debt. The allowance of legal fee claims would not only increase the amount of cash the debtor must come up with to keep the car, but also reduce *pro tanto* the amount of

the debtor's "disposable income" that the unsecured creditors will receive under a chapter 13 plan. Unsecured creditors' legal fee claims will also reduce the payments to the other creditors. Moreover, such a rule would require the periodic recomputation by the chapter 13 trustee of the amount of each creditor's distribution because of the ever-increasing amount of an unsecured creditor's postpetition legal fees. Such recomputation would have to be made in each case, usually monthly, by the standing chapter 13 trustee in the district, who may be responsible for administering thousands of chapter 13 cases, and would pose enormous administrative complications and difficulties in chapter 13 cases.

ARGUMENT

I. BANKRUPTCY CODE § 502(b) SHOULD BE CONSTRUED NARROWLY IN LIGHT OF LONG-STANDING PRECEDENT OF THIS COURT, AND THE STRUCTURE AND GOALS OF THE BANKRUPTCY CODE.

A. In Light of Other Bankruptcy Code Provisions, § 502(b) Should Be Narrowly Construed Not To Allow Unsecured Creditors' Claims For Postpetition Legal Services of No Benefit to The Estate

Section 502(b) should not be construed to allow an unsecured creditor's claim for legal fees because to do so would be contrary to the structure of the Bankruptcy Code, which has many provisions that explicitly provide for the allowance of postpetition legal fees in specific circumstances. See, e.g., §§ 303(i), 330, 331, 362(k), 503(b)(3)(D) and (4), 506(b), and 523(d).

Specifically, only two provisions of the Bankruptcy Code authorize a creditor's claim for postpetition legal fees,

and Petitioner's claim does not fit within either of them. The first is § 503(b)(4), which, in conjunction with § 503(b)(3)(D), authorizes a bankruptcy court to allow as an expense of administration of a chapter 11 case the postpetition legal fees of an attorney for an unsecured creditor in making a "substantial contribution" in the case. The second, § 506(b), allows the legal fees of a secured creditor, but only to the extent that the value of the collateral exceeds the principal and interest of the claim. Petitioner's claim fails to qualify under either of these provisions. In light of these provisions sharply limiting the recognition of claims for postpetition legal fees of creditors' attorneys, § 502(b) should be interpreted narrowly.

B. *Timbers of Inwood* Supports Disallowance of Contractual Postpetition Fee Claims For Unsecured Creditors

The Court's discussion of Bankruptcy Code § 362(d)(1) and § 506 in *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365 (1988), supports the conclusion that § 502(b) should be construed narrowly. There, the Petitioner, a secured creditor whose collateral was worth less than the amount of its claim, argued that it was entitled to periodic payments for the use value of its collateral under the "adequate protection" provision of § 362(d)(1). The Court first stated that § 362(d)(1) could be read to support Petitioner's claim, but rejected that reading because it was implausible to impute to Congress an intent to allow such claims under a general provision, rather than providing for them specifically in § 506(b). As analyzed by Justice Scalia for a unanimous court:

> If the Code had meant to give the undersecured creditor, who is thus denied interest on his *claim*, interest on the value of his *collateral*, surely

> [§ 506(b)] is where that disposition would have been set forth, and not obscured within the "adequate protection" provision of § 362(d)(1). Instead of the intricate phraseology set forth above, § 506(b) would simply have said that the secured creditor is entitled to interest "on his allowed claim, or on the value of the property securing his allowed claim, whichever is lesser."

Id. at 373 (Italics in original). The Court's logic in *Timbers of Inwood* likewise requires the disallowance of a contract claim for postpetition legal fees by an unsecured creditor who has provided no benefit to the estate. If Congress had intended to allow such claims despite the absence of benefit to the estate, it would have simply said so in any of the numerous provisions of the Bankruptcy Code that do authorize postpetition legal fees, and not silently "obscured" the allowance of such claims within the general language of § 502(b).

Moreover, the Court pointed out in *Timbers of Inwood* that § 506 has the "substantive effect of denying undersecured creditors postpetition interest on their claims" by not providing for it. 484 U.S. at 372. Section 506, which deals with attorneys' fees, as well as interest, should have the same substantive effect of disallowing postpetition attorneys' fees for undersecured creditors, and by extension for wholly unsecured creditors as well. See Liore Z. Alroy and J. Michael Mayerfeld, *Contracted-For Post-Petition Attorneys' Fees and Collection Costs; United Merchants Revisited*, 1992 Colum. Bus. L. Rev. 309, 321-23 ("Timbers suggests that attorneys' fees ought not to be allowed to anyone save an oversecured creditor with a contract providing for collection costs").

C. Under *Randolph v. Scruggs* and Other Cases, Unsecured Creditors Should Be Allowed Claims For Postpetition Legal Fees Only If The Attorney's Services Were Beneficial To The Estate.

Long ago, in *Randolph v. Scruggs*, 190 U.S. 533 (1903), this Court formulated the requirement of "benefit to the estate" for the allowance of unsecured creditors' contract claims for postpetition legal fees. As stated by Justice Holmes for the Court:

> We are not prepared to go further than to allow compensation for [legal] services which were *beneficial to the estate*.

190 U.S. at 539 (Italics added).

Randolph v Scruggs appears to be the only case in which this Court has ruled on the allowability in bankruptcy of a claimant's unsecured contract claim for postpetition legal fees it incurs during a bankruptcy case. In the *Amici's* view, *Randolph v. Scruggs* is controlling.

In *Randolph v. Scruggs*, an assignment for the benefit of creditors made by a debtor pursuant to state law was superseded by a subsequent involuntary bankruptcy filing. The pre-bankruptcy assignment contract between the debtor-assignor and the assignee provided for the payment of fees of the assignee's attorneys. Based on the prepetition contract clause for legal fees, the assignee's attorneys filed a claim against the bankruptcy estate for their fees for various services, including advice to the assignee with respect to his duties, and in resisting adjudication in bankruptcy of the debtor-assignor *during the bankruptcy case*. The Court held that the attorneys' contract claim for legal fees, including such claim for *postpetition* legal services, could be allowed

only if the legal services were beneficial to the bankruptcy estate, stating: "The services to the voluntary assignee may be allowed so far as they *benefited the estate.*" 190 U.S. at 539 (Italics added).

This Court thus held in *Randolph v. Scruggs* that the attorneys' services for resisting such adjudication during the bankruptcy case did not give rise to an allowable claim because they were of no benefit to the estate. With respect to the claim based on the attorneys' advice to the assignee, the Court ruled that a remand was necessary for factual findings as to whether such advice was beneficial to the estate. Petitioner does not pretend that any of the legal services of its attorneys were beneficial to the estate. Under *Randolph v. Scruggs*, its contract claim for postpetition legal fees must be disallowed.[6]

The doctrine for charging one party's legal fees to a group that benefited from them has its origin in *Internal Imp. Fund Trustees v. Greenough*, 105 U.S. 527, 531-32, 535-36 (1881), and has been applied ever since. See *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 392 (1970); *Boeing Co. v. Van Gemert*, 444 U.S. 472, 478 (1980); *Vizcaino v. Microsoft Corp.*, 290 F.3d 1043, 1051-52 (9th Cir.), cert denied 537 U.S. 1018 (2002).

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[6] Petitioner's heavy reliance on the *dicta* of the Second Circuit in *In re United Merchants & Mfrs., Inc.*, 774 F.2d 134 (2d Cir.1982), a decision under the prior Bankruptcy Act offering the court's interpretation of then newly-enacted § 506(a) of the Bankruptcy Code, is entirely misplaced. Not only is that opinion *dicta* because § 506 was inapplicable, but also it is unlikely that the Second Circuit would currently hold that contract claims for such postpetition services may be allowed. See *In re Sokolowski*, 205 F.3d 532, 535 (2d Cir. 2000) (disallowing a claim for attorneys' fees).

The principle established by *Randolph v. Scruggs* has been adhered to by the courts. See *Saper v. John Viviane & Sons, Inc.*, 258 F.2d 826, 828 (2d Cir. 1958) ("[A]s a general rule no compensation or reimbursement can be had unless a tangible benefit has been conferred on the estate to the advantage of the creditors as a whole."); *In re Friedman*, 232 F.3d 151 (2d Cir. 1956); *In re Solar Mfg. Corp.*, 206 F.2d 780, 781 (3d Cir. 1953) (the work of attorneys for creditors "must be at the expense of their clients unless it is in some manner beneficial to the estate"); *Guerin v. Weil, Gotshal & Manges*, 205 F.2d 302, 304 (2d Cir.1953) (In the absence of benefit to the estate, "the bankruptcy court lacks power to grant, and the policy of the [Bankruptcy] Act is against, compensation not expressly provided for by the Act."); *Matter of Saphire Steamship Lines, Inc.*, 509 F.2d 1242, 1245 (2d Cir.1975); *Matter of Consol. Bancshares, Inc.*, 785 F.2d 1249, 1253 (5th Cir. 1986) ("[A] creditor's attorney must ordinarily look to its own client for payment, unless the creditor's attorney ... *conferred a significant and demonstrable benefit* to the debtor's estate and the creditors.") (Italics in original); *In re Lister*, 846 F.2d 55, 57 (10th Cir. 1988).

If Congress had intended, when enacting § 502(b) and § 506, to overturn *Randolph v. Scruggs* or the subsequent cases conditioning the allowance of an unsecured creditor's postpetition fee claim on benefit to the estate, it would have said so explicitly in either of those provisions or in their legislative history. See *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) ("When Congress amends the bankruptcy laws, it does not write on a clean slate [and] this Court has been reluctant to accept arguments that would interpret the Code ... to effect a major change in pre-Code practice that is not at least the subject of some discussion in the legislative history."). See also, *Midlantic Nat'l Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. 949, 501 (1986)

("[I]f Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific.").

The doctrine of *Randolph v. Scruggs* requiring benefit to the estate has been carried into the Bankruptcy Code in § 503(b)(3)(D) and (4), which allows legal fees to the attorney for an unsecured creditor who has made a "substantial contribution" in a chapter 11 case. Petitioner ignores this Code provision in its argument that Congress meant for postpetition legal fees to be payable whenever provided for by a contract clause. But the long-standing rule of *Randolph v. Scruggs*, which is carried into § 503(b)(3)(D) and (4), eviscerates Petitioner's argument. Something more is required of an unsecured creditor for it to grasp a disproportionate share of the bankruptcy estate – it must substantially contribute to that estate to recover its attorney's fees. See *Lebron v. Mechem Financial, Inc.* 27 F.3d 937, 944 (3d Cir. 1994) ("[T]he purpose of § 503(b)(3)(D) is to encourage activities that will benefit the estate as a whole...."). See also *Official Committee of Cybergenics*, 330 F.3d 548, 564 (3d Cir. 2003) (§ 503(b)(3)(D) and (4) continues the benefit policy of § 64(a)(1) of the former Bankruptcy Act allowing a creditor to recover expense incurred "which actually benefits the estate."). In addition, the courts have developed a stringent standard for the allowance of fee claims of attorneys for unsecured creditors pursuant to § 503(b)(3)(D) and (4). As stated in *Lebron, 27* F.3d at *944,* the applicable test for determining whether there has been a "substantial contribution" is whether the efforts of the applicant resulted in "an actual and demonstrable benefit to the debtor's estate [and] the creditors." Accord: *In re Granite Partners, L.P.*, 213 B.R. 440, 446 (Bankr. S.D.N.Y. 1997); *In re Alumni Hotel Corp.*, 203 B.R. 624, 632 (Bankr. E.D. Mich. 1996). In the present case, Petitioner does not

make any pretense that its attorneys' services provided any benefit whatever to the estate or the creditors.[7]

D. The Bankruptcy Courts Have Exclusive Jurisdiction Over Legal Fees In Bankruptcy Cases; Such Fees Are Not A Matter For Private Agreements

A fundamental principle of the bankruptcy law is that the bankruptcy courts have *exclusive* jurisdiction over the property of the debtor estate from the moment that the debtor's bankruptcy case has been commenced. See *New Haven Inclusion Cases*, 399 U.S. 392, 420-21 (1970). Such exclusive jurisdiction of the bankruptcy courts was carried into the 1978 bankruptcy jurisdictional legislation as 28 U.S.C. § 1334(e). See *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 447 (2004) (relying on 28 U.S.C. § 1334(e)).

Among the matters central to bankruptcy that are within the exclusive jurisdiction of the bankruptcy courts is the conduct of litigation in those courts and the determination of issues regarding legal fees incurred in connection therewith. See *Leiman v. Gutman*, 336 U.S. 1, 9 (1949) ("...[T]he determination of [legal fee] allowances has been made an integral part of the process of confirmation which is

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[7] To the extent that a contract clause triggers an obligation for postpetition legal fees because of a bankruptcy filing, it is in the nature of an *ipso facto* provision and should be held unenforceable for that reason as well. See §§ 365(e)(1) and 541(c)(1)(B); *In re Southern Pacific Funding Corp.*, 268 F.3d 712, 716 (9th Cir. 2001) (*ipso facto* provisions are intended "to protect the debtor from enforcement of unfavorable insolvency-triggered clauses"); *In re Triangle Lab., Inc.*, 663 F.2d 463, 465 (3d Cir. 1981) (Congress outlawed *ipso facto* clauses under the Bankruptcy Code to protect and maximize the estate, indicating a strong policy against such provisions).

exclusively entrusted to the bankruptcy court...."); *Brown v. Gerdes*, 321 U.S. 178, 188 (1944) (the bankruptcy court has "exclusive authority" to determine bankruptcy fees payable out of the estate). Significantly, the Court has refused to enforce "private arrangements" fixing bankruptcy fees that were not even payable out of the estate. See *Leiman v. Gutman*, 336 U.S. at 4, 8. Accord: *In re Kisselberth*, 273 F.3d 714, 718-19 (6th Cir. 2001); *In re Inslaw*, 106 B.R. 331, 333 (Bankr. D.C. 1989) ("In a bankruptcy case fees are not a matter for private agreement."); *In re 5900 Assoc., Inc.*, 468 F.3d 326, 329 (6th Cir. 2006) (The debtor and an attorney "cannot, simply by entering into a state law contract, abridge the court's duty to monitor such fees."); *In re Gulf Hills Dev. Corp.*, 60 B.R. 366, 369 (S.D. Miss. 1985). See also, S. Rep. 95-989, 95th Cong., 2d Sess. 40 (1978) ("In a bankruptcy case fees are not a matter for private agreement.").

E. Section 502(b) Should Be Narrowly Construed In View of The Bankruptcy Code's Distinction Between the Prepetition and Postpetition Periods

The Bankruptcy Code distinguishes between the prebankruptcy and the postbankruptcy periods:

> For more than a century and a half the theory of the English bankruptcy system has been that everything stops at a certain date. Interest was not computed beyond the date of the commission....[T]he rule was laid down not because of the words of the statute, but as a fundamental principle. We take our bankruptcy system from England, and we naturally assume that the fundamental principles upon which it was administered were adopted by us when we copied the system....

Sexton v. Dreyfus, 219 U.S. 339, 344 (1911) (per Holmes, J).

The Bankruptcy Code also structures the date of commencement of a bankruptcy case as a temporal date for the determination of claims against the estate and the scope of property of the estate. See § 502(b), § 503(b) and § 541. Thus, under § 502(b), the amount of every claim must be determined "as of the date of the filing of the petition" commencing the bankruptcy case.

The Bankruptcy Code also divides claims into two categories depending on whether they arose before or after the date of the filing of the bankruptcy petition. The claims of "creditors" are those that arise at the time of or before the commencement of the bankruptcy case.[8] Claims arising after the commencement of the bankruptcy case that provide a benefit to the estate constitute "administrative expenses" of the case under § 503(b), and they are accorded priority of distribution under § 507(a)(2) because they benefit the estate by enabling the debtor in possession or the trustee to administer the estate, and to operate the debtor's business.

The determination and allowance of claims as of the filing date, with payment as administrative expenses only for expenditures benefiting the estate during its administration, is fundamental to the bankruptcy system. See *Matter of Brints Cotton Marketing, Inc.*, 737 F.2d 1338, 1342 (5th Cir. 1984) (A creditor cannot "improve his position viz-a-viz other creditors by action taken by him post-petition," citing *Sexton v. Dreyfus*, 219 U.S. 339 (1911)). See also, *In re Sakowitz, Inc.*, 110 B.R. 268, 271 (Bankr. S.D. Tex. 1989) (disallowing

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[8] Under § 101(10), a "creditor" is defined as an entity whose claim against the debtor arose at the time of or before the "order for relief" in the case; and under § 301(b), the commencement of a voluntary bankruptcy case constitutes an order for relief in the case. In an involuntary bankruptcy case, if the petition is not dismissed after trial, the bankruptcy court enters an order for relief pursuant to § 303(h).

a claim for postpetition legal fees because "Section 502(b) speaks in terms of the proof of claim *as it existed at the time of the filing of the case.")* (Italics in original).

Legal fees incurred by a creditor after the commencement of the bankruptcy case are of the same quality as interest that would otherwise accrue after bankruptcy, and should be disallowed under the fundamental principle adopted by this Court in *Sexton v. Dreyfus* and followed thereafter by the courts.

F. Interpretation of § 502(b) In Light of the Principle of Equality of Distribution For Creditors

A prime policy of the bankruptcy law, established long ago, is "to secure equality among the creditors of a bankrupt." *Boese v. King*, 108 U.S. 379, 385-86 (1883). The Court has continued to apply this policy through the years. See, e.g., *Clarke v. Rogers*, 228 U.S. 534, 548 (1913); *Young v. Higbee*, 324 U.S. 204, 210 (1945); *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991). This policy was carried into the Bankruptcy Code by § 1123(a)(4), which requires that a chapter 11 plan provide "the same treatment for each claim ...of a particular class."

Indeed, Petitioner recognizes this basic bankruptcy policy, Pet. Op. Br., p. 45,[9] but contends that equality is served by allowing creditors with provisions for attorneys' fees to increase their claims by adding postpetition fees to their claims. The cases it cites for this proposition are inapposite because they concern either a secured creditor, or an unsecured creditor who obtained a judgment against the debtor *personally* on a debt found to be non-dischargeable

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[9] Citations in this form are to pages of Petitioner's opening brief.

pursuant to § 523(a).[10] Secured creditors are entitled to look to their collateral for the payment of their claims in priority to the unsecured creditors, and their rights to collect interest and legal fees up to the limit of their collateral value is the exception that underscores the rule. Only "to the extent" of that collateral value do secured creditors receive that special right to collect interest and attorneys' fees. This principle was thoroughly analyzed in *Timbers of Inwood*, 484 U.S. at 373. With regard to unsecured creditors' claims, the six decisions by courts of appeals relied upon by Petitioner, Pet. Op. Br., p. 25,[11] are also inapposite. In each of those cases, the judgment in favor of the creditor was on a debt excepted from the debtor's discharge under § 523(a). Significantly, such a judgment is *not* granted against the debtor estate, but only against the debtor *personally*. The creditor's legal fees allowed in each of those cases was thus borne solely by the debtor personally, not by the debtor estate or the other creditors.

If the debtor estate is required, predicated on a contract clause, to bear the legal fees incurred by an unsecured creditor during the bankruptcy, that creditor would in actuality be preferred over other unsecured creditors, particularly those who become unsecured creditors *involuntarily*, such as the holders of tort claims for personal injuries, or of claims for non-priority federal, state or local

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[10] See § 523 (a), which sets forth 19 particular types of debts of an individual debtor that are excepted from such debtor's discharge in bankruptcy.

[11] *Alport v. Ritter* (*In re Alport*), 144 F,3d 1163, 1168 (8th Cir. 1998); *Davidson v. Davidson* (*In re Davidson*), 947 F.2d 1294, 1297-98 (5th Cir. 1991); *Transouth Fin. Corp. of Fla. V. Johnson* , 931 F.2d 1505, 1507 (11th Cir. 1991); *Jordan v. Southeast Nat'l Bank*, 927 F.2d 221, 227 (5th Cir. 1991); *Martin v. Bank of Germantown* (*In re Martin*), 761 F.2d 1163, 1168 (6th Cir. 1985); *Worthen Bank & Trust Co. v. Morris* (*In re Morris*), 602 F.2d 826, 828-29 (8th Cir. 1979).

taxes. None of the involuntary unsecured creditors could have negotiated before bankruptcy for provisions allowing legal fees they might incur in a subsequent bankruptcy. Moreover, many trade creditors and suppliers who operate small businesses lack sufficient bargaining power to obtain contracts affording them coverage for their legal fees incurred in a subsequent bankruptcy. If such postpetition fee claims are allowed, many unsecured creditors would not be on an equal footing with those who have the prepetition ability and leverage to obtain fee-shifting clauses. The principle of the bankruptcy law for equality of treatment for unsecured creditors thus requires the disallowance of Petitioner's claim.

Petitioner calls on equity to support its effort to gain more than the other general creditors. Pet. Op. Br., p. 49. Rather, equity calls for the disallowance of Petitioner's claim so as to avoid conferring a postpetition benefit on it that other creditors, whose claims do not arise under contracts, could never obtain. See *Pepper v. Litton*, 308 U.S. 295, 305 (1939) ("Equitable powers are to be exercised on the allowance of claims....").

II. CONGRESS COULD NOT HAVE INTENDED TO ALLOW UNSECURED CREDITORS' CONTRACT CLAIMS FOR POSTPETITION LEGAL FEES IN LIGHT OF THE SEVERE ADVERSE CONSEQUENCES SUCH ALLOWANCE WOULD HAVE ON THE ADMINISTRATION OF CHAPTER 11 AND CHAPTER 13 CASES

A. Allowing Such Claims Would Cause Unwarranted Escalation of Monitoring Activities By Individual Creditors and Mounting Expense for the Estate

If the Court were to sustain such legal fee claims, its decision will alert lenders and others who extend credit to

focus on the need to include or revise the fee-shifting clauses in their standard forms of contracts. Such a rule will likely result in the prevalent use of fee shifting clauses in prepetition contracts and a vast increase in the number of such claims, which could overwhelm the administration of bankruptcy cases. It can be expected that all parties who extend credit will write clauses broadly providing for charging all legal fees of *every* kind they incur in connection with a later bankruptcy case. It is also likely that such claims will be routinely filed even in the absence of any dispute over the unsecured creditor's underlying substantive claim and thus no need for legal representation to establish such claim. As predicted by the court in *In re Sakowitz, Inc.*, 110 B.R. at 275, "Each creditor might send an attorney to every hearing in the case."

Accordingly, such a rule will lead to escalating and often unnecessary legal fees being imposed on the estate in chapter 11 cases at the expense of all of the other creditors, who, through the estate, are already bearing the fees of the attorneys for the official creditors' committee for serving *all* of the creditors. See Kenneth N. Klee and K. John Shaffer, *Creditors' Committees Under Chapter 11 of the Bankruptcy Code*, 44 S. Carolina L. Rev. 995, 997 (1993) (discusses the role, functions and operation of official creditors' committees in chapter 11 cases). The official creditors' committee participates in the numerous bankruptcy-specific proceedings that are conducted during chapter 11 cases, and is specifically required by § 1102(b)(3) to provide access to relevant information to all of the creditors, and gives additional reports and disclosure to the creditors as required by the bankruptcy court. Yet if Petitioner wins the day in this case, bankruptcy estates will be burdened with legal fees that creditors may choose to incur for having their own attorneys monitor and otherwise participate in these proceedings.

Fee-shifting clauses encourage the pursuit of litigation, *Ruckelshaus v. Sierra Club*, 463 U.S. 680, 687 (1983). Chapter 11 is intended to provide a framework for the consensual and cooperative resolution of disputes and the reorganization of the debtor, a purpose that would be undermined by a rule allowing recovery of postpetition legal fees. See *In re Combustion Engineering, Inc.*, 391 F.3d 190, 244 (3d Cir. 2004).

This problem is especially heightened in chapter 11 cases, which are significantly different than conventional two-party litigation in the federal district courts. A chapter 11 case is not litigation between parties as such, but is a forum for the adjudication of numerous bankruptcy-related separate proceedings that affect all unsecured creditors as a group.[12] The effect of the myriad of bankruptcy-related proceedings is generally the same for all unsecured creditors, rather than affecting the rights of particular creditors, and is adequately addressed for unsecured creditors as a group by the attorney for the official creditors' committee. However, bankruptcy attorneys representing creditors in chapter 11 cases tend to participate in such proceedings even though the interests of their clients are not challenged or at risk. It is not uncommon for creditors' attorneys, as here, to inject themselves into proceedings for bankruptcy court approval of disclosure statements pursuant to § 1125 and for confirmation of plans of reorganization pursuant to § 1129.

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[12] Such bankruptcy-specific proceedings affect the unsecured creditors as a group, and often do not affect the allowance of the individual claims of the creditors. Proceedings of this type arise under § 362(d) (relief from the automatic stay), § 363(b) (sale of assets), § 364 (borrowing money), § 365 (assumption and rejection of executory contracts), § 1104 (appointment of a trustee), § 1113 (rejection of collective bargaining agreements), § 1114 (payment of retiree benefits), and § 1121(d) (changing the debtor's exclusive period to file a chapter 11 plan).

If unsecured creditors are allowed legal fees under contract clauses, it will be necessary for the bankruptcy courts to sort out whether and to what extent such legal services are within the applicable contract clause and to adjudicate the value of unnecessary and duplicative legal services of creditors' attorneys. A rule allowing legal fees of unsecured creditors incurred for their attorneys' appearance at these proceedings would result in a large number of claims aggregating large amounts against the estate, and reduce the distributions from the "pot" that would otherwise be available for all of the unsecured creditors.

Because bankruptcy proceedings are multi-party with shifting alliances, quite different than standard two-party lawsuits, bankruptcy courts may be hard-pressed to evaluate the results achieved by attorneys for unsecured creditors and determine who was the winner. See *Ruckelshaus v. Sierra Club*, 463 U. S. at 684 (after referring to the basic American rule against fee-shifting, stating: "It is clear that generations of American judges, lawyers and legislators...would regard it as quite 'inappropriate' to award the 'looser' an attorney's fee from the 'prevailing litigant.'").

In light of these consequences, Congress could not have intended § 502(b) to be a basis for the allowance of claims by unsecured creditors for postpetition legal fees.

B. Allowing Postpetition Legal Fees to Unsecured Creditors Will Overly Complicate Chapter 11 Cases

The allowance of postpetition legal fee claims to unsecured creditors will overly complicate chapter 11 cases, increase the legal fees the estate must bear, thereby diluting the "pool" of assets available for all other unsecured creditors, and delay their administration and conclusion.

Unsecured creditor legal fee claimants will, as Petitioner did here, increasingly file so-called "contingent" protective claims at the outset of the case. Contingent claims constitute "claims" under the Bankruptcy Code because they are within § 101(5)'s definition of a "claim." At the beginning of a chapter 11 case, when creditors file contingent claims, an unsecured creditor will not know whether, or the extent to which, it will thereafter incur legal fees in the case because it will not know what proceedings will be commenced in the case and whether its claim will be challenged. The contingent claim for future legal fees will thus amount to nothing more than a guess by the unsecured creditor.

To be an allowed claim entitled to vote on a chapter 11 plan and participate in distributions thereunder, however, such contingent claim must be estimated pursuant to § 502(c), or adjudged to be in a particular amount in a litigated proceeding. Section 502(c) requires that an "estimation" proceeding be conducted, at which evidence may be adduced and in which the bankruptcy court makes an educated guess as to the ultimate value of the claim. See *In re Nova Real Estate Inv. Trust*, 23 B.R. 62, 66 (Bankr. D. Va. 1982) ("An estimate necessarily implies no certainty"). Cf. *Dunbar v. Dunbar*, 190 U.S. 340, 345 (1903) (There is an "innate difficulty, if not impossibility, of estimating or valuing" many contingencies). The estimate is made before any legal services of the unsecured creditor's attorney have been rendered and will ascribe value to various possible future proceedings that may never be commenced or disputes involving the unsecured creditor that may never arise. This makes estimation of future legal services in the chapter 11 context a speculative matter. It is thus not a satisfactory process for the allowance of an unsecured creditor's legal fee claim in a chapter 11 case.

On the other hand, the alternative of liquidating the contingent legal fee claim of the unsecured creditor by an adjudication is likewise unattractive. Among other things, it could require the bankruptcy court to conduct several proceedings at different stages of the chapter 11 case in order to determine the total amount to which the creditor would be entitled for its legal fee claim. All of these proceedings would occur in the face of the Court's admonition in *Hensley v. Eckerhart*, 461 U.S.424, 437 (1983), that "A request for attorney's fees should not result in a second major litigation." But that is exactly what may happen if unsecured creditors are allowed postpetition legal fees under contract clauses.

Even if the determination of the amount of an unsecured creditor's claim is not made until later in the case, there may initially be a proceeding by the unsecured creditor to determine the amount of the claim so as to establish its voting rights. The unsecured creditor's attorney will likely thereafter continue to render legal services as the chapter 11 case moves forward to other stages of the confirmation process including among others, proceedings for approval of disclosure statements under § 1125 required for the solicitation of acceptances of the plan and for its confirmation. After the creditor's attorney monitors or otherwise participates in those proceedings, more litigation will be required to determine the amount of the fees to be allowed for that participation. And even that may not be the end of the story. If the proposed plan is not accepted by creditors or is not confirmed for other reasons, still another proposed plan of reorganization will emerge, only to be followed by still another round of fee litigation with the unsecured creditor. All of these proceedings would consume a substantial amount of time of the bankruptcy court as well as for the attorneys for the chapter 11 debtor in possession (or trustee) and for the official creditors' committee, all at the expense of the debtor estate.

Moreover, a rule allowing unsecured creditors' claims for postpetition legal fees may interfere with the formulation on a timely basis of the terms for reorganization by the debtor or another potential proponent of a plan of reorganization. Such terms are formulated in part on the basis of the total amount of all of the claims against the debtor. Information as to the universe of claims against the debtor is thus needed by the debtor and others who seek to pursue reorganization alternatives. The continuous stream of services by unsecured creditors' attorneys throughout the case and the continued accrual of the fees therefor, however, will stand in the way of determining on a timely basis the universe of claims against the debtor.

C. Unsecured Creditors' Legal Fee Claims Should Not Be Allowed Because of the Serious Consequences Allowance Would Have on Chapter 13 Debtors and Their Unsecured Creditors

A rule interpreting § 502(b)[13] to allow postpetition legal fee claims of unsecured creditors under fee-shifting clauses would have a serious adverse effect on chapter 13 debtors, and also on all of their unsecured creditors. Such a rule would also create unmanageable administrative difficulties in computing and making the periodic distributions, usually monthly, of the debtor's "disposable income"[14] to the unsecured creditors pursuant to confirmed chapter 13 plans. § 1325(b)(1)(B). This is because it would

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[13] Under § 103(a), § 502(b) applies in chapter 13 cases as well as chapter 11 cases.

[14] Section 1325(b)(2) defines "disposable income" as all of the current income monthly income of the debtor (excluding certain support obligations and payments) less amounts reasonably necessary for support of the debtor and dependants, and certain charitable contributions and certain business expenses if the debtor is engaged in a business.

be essential to recompute each creditor's share of such distributions every time that a creditor's attorney renders additional legal services.

The problems caused by the allowance of such claims would be acute in light of the enormous volume of chapter 13 cases. During the 12 months ended June 30, 2006, there were 313,085 chapter 13 filings[15] and thousands more than that number of chapter 13 cases are currently being administered. In light of that high volume, allowing postpetition legal fee claims would be a nightmare in chapter 13 cases, and specifically for chapter 13 trustees, who are the ones who make the payments to the unsecured creditors under the plan pursuant to § 1326(c), and who may be held personally liable for errors in making distributions to the creditors. See *In re Wilson*, 274 B.R. 4 (Bankr. D.C. 2001).

In most districts, a standing chapter 13 trustee is appointed to administer all of the chapter 13 cases in the district, § 1302(a), and the single chapter 13 trustee is thus often responsible for thousands of chapter 13 cases at a time. If unsecured creditors' postpetition fee claims were to be allowed, it would be a virtual impossibility for these chapter 13 trustees to make the periodic recomputations of claims and distributions to creditors on a timely basis, and it could be necessary to defer distribution to creditors for five years until the end of a chapter 13 case, § 1322(d), instead of much earlier periodic distributions in chapter 13 cases.

Moreover, the Court should not adopt a rule allowing postpetition fee claims by unsecured creditors because it would operate against the interests of both the chapter 13

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[15] This number was compiled by the Administrative Office of the United States Courts. See http://www.uscourts,gov/bnkrpctystats/bankrupt_f2table_jun2006.xls.

debtor and all of the debtor's unsecured creditors. First, chapter 13 debtors often need to retain their automobiles to get to and from work. Over 77% of workers in America use their cars for that purpose.,[16] and given the dependence on cars for getting to work, making cars a vital component of gaining a "fresh start." See Keith M. Lundin, *Chapter 13 Bankruptcy* § 518.1 (3d ed. 2006). In order to retain his or her car, § 1325(a)(5)(B) requires a chapter 13 debtor to pay the holder of a purchase money lien securing the vehicle the full amount of "the underlying debt determined under nonbankruptcy law" if such debt arose within 910 days before the bankruptcy filing and the car was acquired for personal use.[17] See *In re Fleming*, 339 B.R. 716, 722 (Bankr.E.D. Mo. 2006) (stating that it is irrelevant that the value of the collateral is less than the underlying debt); *In re Johnson*, 337 B.R. 269, 272-73 (Bankr. M.D.N.C. 2006); *In re Ezell*, 338 B.R. 330, 340-41 (Bankr. E.D.Tenn. 2006); *In re Brown*, 346 B.R. 868, 876 (Bankr. N.D.Fla. 2006). If, as in many chapter 13 cases, the lienholder's claim is more than the value of the car, the debt to such undersecured creditor would, if such rule is adopted, include unsecured postpetition legal fees as part of the "underlying debt." This will make it more difficult for the debtor to be able to retain the car, because to do so, the financially embarrassed debtor will have to come up with even more cash to cover the legal fees as part of the underlying debt to the vehicular financier, or loose the car. This could impair the debtor's "fresh start,"

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[16] U.S. Census Bureau, 2005 American Community Survey, http://factfinder.census. Gov/servlet/STTable

[17] The so-called "hanging paragraph" of §1325(a), which immediately follows the first sentence of § 1325(a)(9), makes § 506(a), which reduces the secured portion of an undersecured claim to the value of the collateral, inapplicable to the determination of the amount of the"underlying debt" for the purpose of § 1325(a)(5) if the debt arose within 910 days before the bankruptcy filing and the car was acquired for the debtor's personal use.

which is a main purpose of the bankruptcy law. See *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913); *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

There is another compelling reason for the disallowance of such claims. The obligation to pay such car lenders more than their collateral value was enacted in 2005 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act. That Act significantly amended both chapter 7 governing liquidation proceedings, in which unsecured creditors rarely receive any distribution from the individual debtor's chapter 7 estate, and chapter 13, under which unsecured creditors are likely to receive periodic distributions under confirmed plans. Congress' purpose was to ensure that unsecured creditors of individual debtors seeking bankruptcy relief would receive distributions from the debtors' post-petition wages. Cf. *In re Meza*, 467 F.3d 874, 877 (5th Cir. 2006) (Chapter 13 enables individual debtors "to amortize their debts out of future earnings," and "permits wage-earning debtors 'to reorganize with a repayment plan as an alternative to seeking a complete discharge of debts through the chapter 7 bankruptcy liquidation process.'"). To accomplish that objective, Congress restructured chapter 7 to require the dismissal of an individual debtor's chapter 7 case unless the debtor's monthly income is less than the statutory level, which § 707(b)(2) fixes at a relatively low amount. This makes chapter 7 unavailable to many individual wage earners, and leaves as their only bankruptcy alternative a proceeding under chapter 13, which, to accomplish Congress' purpose, requires the distribution of *all* of the debtor's "disposable income" to his or her unsecured creditors during the multi-year life of a chapter 13 plan. See *In re Fuller*, 346 B.R. 472, 484 (Bankr. S.D. Ill. 2006); *In re Fuger*, 347 P.R. 94, 99 (Bankr. D. Utah 2006).

The allowance of postpetition legal fee claims would result in a significant reduction in the amount of the chapter 13 debtor's "disposable income" and thus in a dollar for dollar reduction in the distributions targeted by Congress for the unsecured creditors in chapter 13 cases. This is because the allowance of postpetition legal fees to an *undersecured* creditor, which must be paid by a chapter 13 debtor to retain his or her car, would reduce the debtor's "disposable income" and thereby reduce the amount distributable to all of the other unsecured creditors. Moreover, the allowance of postpetition fee claims of *wholly unsecured* creditors would itself increase the aggregate amount of all unsecured claims, thereby diluting every unsecured creditor's *pro rata* share of all distributions of the debtor's "disposable income."

A rule allowing unsecured creditors' postpetition legal fee claims would not only be administratively unmanageable, but also would be harmful to the unsecured creditors.

CONCLUSION

For the foregoing reasons, the order appealed from disallowing Petitioner's claim should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA,
Petitioner,

v.

PACIFIC GAS AND ELECTRIC COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR AMICUS CURIAE AMERICAN INSURANCE ASSOCIATION IN SUPPORT OF PETITIONER

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IN THE

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TRAVELERS CASUALTY AND
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PACIFIC GAS AND ELECTRIC COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Amicus curiae American Insurance Association (AIA) respectfully submits this brief in support of petitioner.[1]

When a debtor seeks bankruptcy protection, the various creditors to whom the debtor owes money may file "proofs of claim" in which they seek a determination of the amount of their claim. 11 U.S.C. § 501(a). Any "party in interest," meaning the debtor, another creditor, or any other entity with a stake in the bankruptcy (such as an insurer that may ultimately be asked to satisfy the claim), may file an objection to the "allowance" of that claim. *Id.* § 502(b). If the claim is objected to, the bankruptcy court is required to determine the amount of the allowed claim. Once a claim is allowed, the creditor receives its distribution from the bankruptcy estate, on a *pro rata* basis, according either to the statutory priority scheme, or the terms of a confirmed plan of reorganization, based on the amount of that allowed claim.

[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than the named amicus curiae, its members, and its counsel made any monetary contribution toward the preparation or submission of this brief. Blanket consent for the filing of amicus briefs has been lodged with the Clerk of the Court by both parties.

This case presents a straightforward question: whether a bankruptcy court, in deciding whether (and in what amount) to "allow" a claim, is required, absent contrary direction from the Bankruptcy Code, to make this decision by reference to applicable nonbankruptcy law—typically state law—or whether a background principle of "bankruptcy policy" may authorize the court to adopt a different rule of decision in determining whether to allow a claim in bankruptcy.

AIA, as amicus curiae, submits that, as the statutory language and the decisions of this Court have long provided, questions of claims allowance are to be determined according to the applicable principles of nonbankruptcy law. To hold otherwise, as the Ninth Circuit did below, risks inviting forum shopping. If a valid state law claim could be disallowed in bankruptcy, a debtor might have an incentive to seek bankruptcy protection to gain a litigation advantage over a plaintiff in litigation. By contrast, if bankruptcy law could provide a more generous scheme of claims allowance than otherwise applicable nonbankruptcy law, creditors who are unhappy with the substantive law that would otherwise govern their claims would have an incentive to precipitate a bankruptcy filing, with the intention of winning a friendlier forum for deciding the validity and amount of the debt allegedly owed to them. These incentives may be particularly powerful in cases, such as several pending mass-tort bankruptcies, in which the debtor's business assets are nearly (or entirely) depleted before the bankruptcy filing, but substantial insurance assets remain available to satisfy creditors' claims.

In order to discourage such misuse of the bankruptcy process, this Court should adhere to the well-established principle that, absent a specific provision of the Bankruptcy Code that requires a different result, questions of claims allowance shall be determined according to otherwise applicable principles of nonbankruptcy law.

INTEREST OF AMICUS CURIAE

AIA is the foremost national trade association representing major property and casualty insurers writing busi-

ness across the country and globally. AIA advocates sound and progressive public policies on behalf of its members in legislative and regulatory forums at the state and federal levels and files amicus briefs in cases before federal and state courts on issues of importance to the insurance industry and the insurance marketplace.

Many AIA members issue or have issued insurance policies covering the liability risks of their policyholders. Accordingly, when policyholders seek bankruptcy protection, one consequence of which is that the policyholder's liability (such as its tort liability) may be determined not in the state court system, but rather according to mechanisms established in bankruptcy court, AIA's members are "parties in interest" with a tremendous stake in this bankruptcy process. Indeed, in recent years, some number of bankruptcy cases have been filed in which a principal purpose of the bankruptcy case is to replace a regime of otherwise applicable law that might weed out invalid or fraudulent tort claims, with one that would more liberally provide for the "allowance" of such claims without the scrutiny that might be brought to bear in the tort system. Following the "allowance" of such claims, the claimants would then seek to obligate the insurers to pay this contrived and artificially inflated liability.

As such, AIA and its members have a strong interest in seeing to it that this Court adhere to the established principle that claims allowance shall be determined according to otherwise governing principles of nonbankruptcy law, and thus reduce the incentive for forum shopping claimants to precipitate a bankruptcy filing.

STATUTORY PROVISIONS

11 U.S.C. § 502(b) provides, in pertinent part:

> [T]he court, after notice and a hearing, shall determine the amount of [a creditor's] claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that ... such

> claim is unenforceable against the debtor . . . under any agreement or applicable law . . . .

11 U.S.C. § 101(5)(A) provides that the term "claim" means a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured[.]"

STATEMENT OF THE CASE

Prior to Pacific Gas and Electric Company's (PG&E) filing for bankruptcy protection, Travelers Casualty and Surety Company of America (Travelers) had issued surety bonds on PG&E's behalf to various third parties. In connection with the issuance of those surety bonds, PG&E executed a series of indemnity agreements in favor of Travelers (Indemnity Agreements), under which PG&E is obligated to reimburse Travelers for any attorneys' fees that it incurs in connection with Travelers' efforts to enforce or protect its rights incident to the surety bonds. PG&E filed a bankruptcy petition under chapter 11 of title 11 of the United States Code, and Travelers filed an amended proof of claim that asserted its right to recover its attorneys' fees, including fees for work done in connection with the bankruptcy case itself.

The bankruptcy court disallowed Travelers' claim in its entirety on the ground that it was bound by the Ninth Circuit's decision in *Fobian* v. *Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149 (9th Cir. 1991), which held that claims for attorneys' fees shall be disallowed where the issues litigated are matters of bankruptcy law.

Instead of addressing whether Travelers' claim was unenforceable under "any agreement or applicable law," 11 U.S.C. § 502(b)(1), the lower courts relied on generalized policy justifications to support their rulings. The court of appeals decision below states only that "[t]he resolution of all of these proceedings was governed entirely by federal bankruptcy law" and that "attorney fees are not recoverable in bankruptcy for litigation issues peculiar to federal bankruptcy law." Pet. App. 3a. (internal quotations omitted).

Insofar as a court may reach that result as a function of its construction of the terms of the parties' contract, such an outcome may well be correct as a matter of federal bankruptcy law. But neither the statutory language nor this Court's decisions provide any warrant for the creation, as the Ninth Circuit appears to have done, of a substantive rule of bankruptcy law under which attorneys' fees for litigating bankruptcy issues are subject to *per se* disallowance, independent of state contract law and the terms of the parties' agreement.

ARGUMENT

I. THE ALLOWANCE OF CLAIMS IN BANKRUPTCY IS GOVERNED BY OTHERWISE APPLICABLE NONBANKRUPTCY LAW

A. Section 502 Of The Bankruptcy Code Expressly Directs Bankruptcy Courts To Nonbankruptcy Law

Whether a claim is allowable or not is a matter of federal bankruptcy law under section 502 of title 11 of the United States Code. 11 U.S.C. § 502. This provision, however, directs the bankruptcy court to look to the underlying substantive nonbankruptcy law in order to determine whether the claim is valid, and thus "allowable" in bankruptcy. Specifically, section 502(b)(1) provides that a court shall allow a claim except to the extent that "such claim is unenforceable against the debtor ... under any agreement or applicable law[.]" 11 U.S.C. § 502(b)(1). "Thus, in proof of claim litigation under 11 U.S.C. § 502(b)(1), the validity of the claim is determined under state law." *Johnson* v. *Righetti (In re Johnson)*, 756 F.2d 738, 741 (9th Cir. 1985).

That principle is a familiar one in this Court's bankruptcy jurisprudence. In *Butner* v. *United States*, 440 U.S. 48 (1979), for example, this Court noted that while there are a number of specific ways in which the Bankruptcy Code alters parties' rights under state law, Congress had "generally left the determination of property rights in the assets of a bankrupt's estate to state law." *Id.* at 54.

Butner thus dictates that "in the absence of specific statutory provisions to the contrary, property interests should not be analyzed differently as a result of a party's in-

volvement in a bankruptcy case," and consequently "bankruptcy courts should only modify the usual state-law compendium of rights and remedies if and to the extent that such modifications are specifically authorized or directed by the Bankruptcy Code." *Bank of New England Corp.* v. *Branch (In re Bank of New England Corp.)*, 364 F.3d 355, 363 (1st Cir. 2004).

The federal bankruptcy laws were of course created against the backdrop of nonbankruptcy laws, including state laws regarding property rights. *See In re Chicago, Milwaukee, St. Paul & Pac. R.R. Co.*, 791 F.2d 524, 532 (7th Cir. 1986) ("Bankruptcy law provides a federal machinery for enforcing creditors' rights but the rights themselves are created by state law."); 4 *Collier on Bankruptcy* ¶ 502.03 (15th ed. 2003) ("The validity and legality of claims is generally determined by applicable non-bankruptcy law."). This Court was clear on that point in *Butner*: "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." 440 U.S. at 55; *see also Raleigh* v. *Illinois Dep't of Revenue*, 530 U.S. 15, 19 (2000).

This case can and should be decided on that one principle. The resolution of the specific issue presented in this case—whether Travelers may recover attorneys' fees pursuant to the Indemnity Agreements where it has litigated federal bankruptcy issues—turns simply on the question whether such fees would be recoverable as a matter of nonbankruptcy law, here, basic principles of state contract law. As this Court has consistently and repeatedly observed, "'[w]hat claims of creditors are valid and subsisting obligations . . . is to be determined by reference to state law.'" *Raleigh*, 530 U.S. at 24 (quoting *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156, 161 (1946)); *see also Grogan* v. *Garner*, 498 U.S. 279, 283 (1991) ("The validity of a creditor's claim is determined by rules of state law.").

The bankruptcy scheme takes property rights as it finds them, altering such rights only where Congress has ex-

pressly demanded such change in order to accomplish the policies of the Bankruptcy Code.[2]

B. Federal Law Does Not Require A Different Result

The Ninth Circuit offered no justification for its ruling other than reliance on its decision in *Fobian*, which itself provided scant reasoning for its categorical holding that, as a matter of bankruptcy law, attorneys' fees will not be awarded for litigated issues involving federal bankruptcy law. *Fobian*, 951 F.2d at 1153. The only support provided in the *Fobian* decision is a series of earlier Ninth Circuit opinions refusing to award attorneys' fees in bankruptcy. *See id.* ("'[T]he question of the applicability of the bankruptcy laws to particular contracts is not a question of the enforceability of a contract but rather involves a unique, separate area of federal law.'" (quoting *Collingwood Grain, Inc.* v. *Coast Trading Co. (In re Coast Trading Co.)*, 744 F.2d 686, 693 (9th Cir. 1984))). The effect of the court's holding below is the substitution of federal law for state law with respect to determining the validity of a creditor's property rights, a result this Court has held should not occur "[u]nless some federal interest requires a different result[.]" *Butner*, 440 U.S. at 55. There is no such federal interest here, however, that might justify that result.

While Congress certainly has the authority to preempt contrary state law, U.S. Const. art. VI, cl. 2, there is no suggestion here that state law "interfere[s] with, or [is] contrary to" the Bankruptcy Code. *Hillsborough County, Fla.* v. *Automated Med. Labs., Inc.*, 471 U.S. 707, 712 (1985) (internal quotations omitted).

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[2] A number of specific provisions of the Bankruptcy Code *do* provide that a creditor's allowed claim will differ from that creditor's claim against the debtor under state law. *See, e.g.*, 11 U.S.C. § 502(b)(2) (disallowing a claim for unmatured interest); *id.* § 502(b)(4) (disallowing claim for services of an insider or attorney of the debtor to the extent that the claim exceeds the reasonable value of the services); *id.* § 502(b)(6) (disallowing claims of a landlord for termination of a real property lease, to the extent the claim exceeds a formula set out in the Bankruptcy Code).

State law may be preempted in any of three ways: "State action may be foreclosed by express language in a congressional enactment, by implication from the depth and breadth of a congressional scheme that occupies the legislative field, or by implication because of a conflict with a congressional enactment." *Lorillard Tobacco Co.* v. *Reilly*, 533 U.S. 525, 541 (2001) (citations omitted). No matter what kind of preemption is at stake, however, "[t]he purpose of Congress is the ultimate touchstone of pre-emption analysis." *Cipollone* v. *Liggett Group, Inc.*, 505 U.S. 504, 516 (1992) (internal quotations omitted).

To that end, a congressional intent to preempt state law is not lightly inferred:

> [B]ecause the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action. In all pre-emption cases, and particularly in those in which Congress has legislated in a field which the States have traditionally occupied, we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.

Medtronic, Inc. v. *Lohr*, 518 U.S. 470, 485 (1996) (internal quotations omitted); *see also Davis* v. *Davis (In re Davis)*, 170 F.3d 475, 481 (5th Cir. 1999) ("Deference to our federalism counsels a presumption that areas of law traditionally reserved to the states, like ... property law, are not to be disturbed absent the clear and manifest purpose of Congress." (internal quotations omitted)). The "presumption against displacing state law ... is just as strong in bankruptcy as in other areas of federal legislative power." *Pacific Gas & Elec. Co.* v. *California*, 350 F.3d 932, 943 (9th Cir. 2003), *cert. denied*, 543 U.S. 956 (2004); *Davis*, 170 F.3d at 481; *see also Sears, Roebuck & Co.* v. *O'Brien*, 178 F.3d 962, 966-967 (8th Cir. 1999) (federal bankruptcy law did not preempt Iowa law prohibiting debt collectors from contacting knowingly represented persons; although federal bankruptcy law is "expansive," Congress has not exclusively

regulated relationships between private lawyers and clients, an area typically within state's powers).

Where a federal statute does expressly preempt state law, a court "must in the first instance focus on the plain wording of the clause[.]" *Sprietsma* v. *Mercury Marine*, 537 U.S. 51, 62-63 (2002) (internal quotations omitted). In determining the scope of an express preemption provision, the court "move[s] on, as need be, to the structure and purpose of the Act in which [that provision] occurs." *New York State Conference of Blue Cross & Blue Shield Plans* v. *Travelers Ins. Co.*, 514 U.S. 645, 655 (1995). Where such an express preemption provision operates "in a field which the States have traditionally occupied," it receives a "narrow interpretation." *Medtronic*, 518 U.S. at 485 (internal quotations omitted).

The Bankruptcy Code, of course, contains no provision expressly preempting state law as to contractual obligations to pay attorneys' fees. And this Court has made clear that—while the ultimate touchstone is congressional intent—courts should be even more reluctant to assume that Congress intended to interfere with state laws that merely enforce contractual obligations, as opposed to affirmative state lawmaking or regulation. *See, e.g., Gibbons* v. *Ogden*, 22 U.S. (9 Wheat.) 1, 211 (1824) ("appropriate application of" Supremacy Clause is to "acts of the State Legislatures ... enacted in the exercise of [its] powers"); *Building & Constr. Trades Council* v. *Associated Contractors & Builders of Mass./R.I., Inc.*, 507 U.S. 218, 227 (1993) ("pre-emption doctrines apply only to state *regulation*"); *see also American Airlines, Inc.* v. *Wolens*, 513 U.S. 219, 228-229 (1995) (Airline Deregulation Act, which preempts state regulation of air carrier services, did not preempt state-law breach of contract claims filed by passengers against airline regarding frequent flier programs; contracts were "privately ordered obligations" and did not amount to a law, rule, regulation,

standard, or other provision having the force and effect of law under ADA preemption statute).[3]

Congress surely expressed no intention in the Bankruptcy Code to re-write contractual obligations to pay attorneys' fees. For example, there is certainly nothing in section 502 of the Bankruptcy Code, the provision governing the allowance of claims, suggesting that Congress intended to preempt state law on this issue. To the contrary, section 502 expressly reflects Congress's desire to defer to state law in determining the validity of a claim. A claim shall be allowed except to the extent that "such claim is unenforceable against the debtor ... under any agreement or applicable law[.]" 11 U.S.C. § 502(b)(1). Bankruptcy courts are thus obligated to examine applicable state law, not substitute an untethered federal common law, in determining the allowance of claims.

By contrast, there are several instances in the Bankruptcy Code in which Congress did reflect a clear desire to override the terms of state law and private contracts, and in each instance it made that intent clear. *See* 11 U.S.C. § 363(*l*) (governing use, sale, or lease of property) ("notwith-

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[3] *See also Duvall* v. *Bristol-Myers Squibb Co.*, 65 F.3d 392, 401 (4th Cir. 1995) (express warranty claim not preempted by Medical Device Amendment to Federal Food, Drug, and Cosmetic Act, which preempts state-imposed requirements on medical devices; to extent warranty claims based solely on voluntary promises made by warrantor, not duties imposed under state law, claims were not requirements imposed under state law), *vacated on other grounds*, 518 U.S. 1030 (1996); *American Auto. Mfrs. Ass'n* v. *Commissioner, Mass. Dep't Envtl. Prot.*, 998 F. Supp. 10, 21-24 (D. Mass. 1997) (Section 209(a) of the Clean Air Act, which preempted all state "standards" regarding vehicle emissions, did not apply to private Memoranda of Understanding between state agency and private automakers, as these were private, voluntary agreements, and were not "standards" within the section's preemptive scope; "courts generally restrict federal preemption to state laws, statutes, rules, regulations, and other state provisions having the force and effect of law" and have "made a clear distinction between state-imposed requirements and voluntary contractual agreements" (citations omitted)), *aff'd*, 208 F.3d 1, 7 (1st. Cir. 2000) ("[F]ederal preemption is generally confined to formal state laws and regulations and not applicable to contracts and other voluntary agreements.").

standing any provision in a contract, a lease, or applicable law"); *id.* § 365(e)(1) (governing executory contracts and unexpired leases) ("[n]otwithstanding a provision in an executory contract or unexpired lease, or in applicable law"); *id.* § 365(f)(1) ("[n]otwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law"); *id.* § 541(c)(1) (regarding property of the estate) ("notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law"); *id.* § 1124(2) (governing impairment of claims or interests) ("notwithstanding any contractual provision or applicable law"). And in the context of claims allowance, the various enumerated exceptions set forth in section 502(b) of the Bankruptcy Code expressly describe circumstances in which—notwithstanding the fact that a party may have a "right of payment," *id.* § 101(5)(A), under state law—that party's allowed "claim" under the Bankruptcy Code is calculated by a different means. *See, e.g., id.* § 502(b)(6) (providing for statutory caps on landlord claims for damages for the rejection of a real property lease).

In short, when Congress wished to preempt the terms of private agreements in the Bankruptcy Code, it has said so expressly. And it said nothing to suggest it intended to treat claims for attorneys' fees any differently from any other contractual obligation. On this and most other issues of the "allowance" of claims in bankruptcy, Congress expressly incorporated state substantive law into a bankruptcy court's analysis of the validity of a creditor's claim.

Nor can there be any suggestion that state law is "impliedly preempted" in this context. Such "conflict preemption" applies "where it is impossible for a private party to comply with both state and federal requirements, or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Sprietsma*, 537 U.S. at 64-65 (internal quotations omitted).

Here, there is neither an actual conflict between the Indemnity Agreements and section 502(b) nor do the Indemnity Agreements pose an obstacle to achieving Congress's full purposes and objectives in enacting section 502(b).

Rather, Travelers is seeking only the benefit of the bargain it negotiated with PG&E prior to PG&E's bankruptcy filing. There is no reason at all to believe that Congress intended the Bankruptcy Code to provide a basis for altering any and all state laws that are implicated by a bankruptcy filing—and even less reason to believe that it intended, beyond reducing a creditor's recovery to its *pro rata* distribution on account of its allowed claim, to provide a means for one party to re-write the parties' self-imposed contractual obligations.

To the contrary, the Bankruptcy Code generally takes state law as a given, and is construed to alter state law only in those circumstances in which it expressly so provides. And "[s]imply making a reorganization more difficult for a particular debtor . . . does not rise to the level of stand[ing] as an obstacle to the accomplishment of the full purposes and objectives of Congress." *Baker & Drake, Inc.* v. *Public Serv. Comm'n (In re Baker & Drake, Inc.)*, 35 F.3d 1348, 1354 (9th Cir. 1994) (second alteration in original; internal quotations omitted). Permitting parties to a contract to file claims for attorneys' fees based on the property rights they possess under state law—just as they would if the very same arrangement were negotiated and implemented outside of bankruptcy—would by no means frustrate Congress's purpose in enacting section 502(b) or any other provision of the Code. To the contrary, it is fully consistent with the basic principle that a creditor's property rights in bankruptcy are identical to its rights outside bankruptcy.

Indeed, as far as federal policy is concerned, this Court has long accepted the proposition that even under the prevailing "American Rule," parties may provide by contract for a regime of fee-shifting. *See generally Fleischmann Distilling Corp.* v. *Maier Brewing Co.*, 386 U.S. 714, 717 (1967) (attorneys' fees are not recoverable "in the absence of a statute or enforceable contract providing therefor"); *Summit Valley Indus., Inc.* v. *Local 112, United Bhd. of Carpenters and Joiners of Am.*, 456 U.S. 717, 721 (1982) ("[u]nder the American Rule it is well established that attorney's fees are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefore" (internal quota-

tions omitted)); *Hall* v. *Cole*, 412 U.S. 1, 4 (1973) ("the traditional American Rule ordinarily disfavors the allowance of attorneys' fees in the absence of statutory or contractual authorization" (footnote omitted)); *Alyeska Pipeline Serv. Co.* v. *Wilderness Soc'y*, 421 U.S. 240, 257 (1975) ("the general rule [is] that, absent statute or enforceable contract, litigants pay their own attorneys' fees").

C. The Proper Analysis Is Simply Whether The Disputed Attorneys' Fees Are Permissible Under The Indemnity Agreements

The court of appeals below relied on its decision in *In re Fobian*, 951 F.2d 1149, to conclude that "attorney fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'" Pet. App. 3a (quoting *Fobian*, 951 F.2d at 1153). The Ninth Circuit characterized Travelers' claim as an attempt "to recover fees in bankruptcy for objections to proposed reorganization plans and related bankruptcy proceedings," and thus "[t]he resolution of all of these proceedings was governed entirely by federal bankruptcy law." *Id.* 2a-3a. That is simply incorrect. The fact that federal bankruptcy law applied to the underlying proceedings provides no basis at all for creating a federal common law—independent of whether state law would enforce a contractual obligation—regarding the validity of Travelers' claim for attorneys' fees.

It is thus unsurprising that other courts, those that adhere to the congressional design reflected in the Bankruptcy Code, have rejected the Ninth Circuit's analysis, instead permitting attorneys' fees to be part of an allowed claim where otherwise applicable state law would so provide. *See Alport* v. *Ritter (In re Alport)*, 144 F.3d 1163, 1168 (8th Cir. 1998); *Davidson* v. *Davidson (In re Davidson)*, 947 F.2d 1294, 1298 (5th Cir. 1991); *TranSouth Fin. Corp.* v. *Johnson*, 931 F.2d 1505, 1509 (11th Cir. 1991); *Martin* v. *Bank of Germantown (In re Martin)*, 761 F.2d 1163, 1168 (6th Cir. 1985); *see also* 4 *Collier on Bankruptcy* ¶ 506.04 (15th ed.) (*Fobian* analysis "inverts the proper analysis" because "a claim that is valid under state law is allowable in bankruptcy unless

some provision of the Bankruptcy Code expressly *disallows* it").

The Fourth Circuit has specifically and correctly criticized Ninth Circuit's analysis on the ground that it substitutes federal law for applicable state law, noting that *Fobian* "inappropriately focuses on the presence of issues peculiar to bankruptcy law, rather than on whether the attorneys' fees are properly taken in furtherance of the [contract] and applicable state law." *Three Sisters Partners LLC* v. *Harden (In re Shangra-La, Inc.)*, 167 F.3d 843, 848 (4th Cir. 1999). Section 502(b)(1) instructs the bankruptcy court to determine whether the claim for attorneys' fees are enforceable under "any agreement or applicable law." 11 U.S.C. § 502(b)(1). Consequently, the contracts between Travelers and PG&E—the Indemnity Agreements—must serve as "the measure of their rights," *Chicago, Milwaukee*, 791 F.2d at 529, and not federal common law.

Because the bankruptcy court below incorrectly denied Travelers' claim as a matter of federal bankruptcy law, it never examined the legitimacy of the claim with respect to the terms of the Indemnity Agreement and applicable state contract law. Accordingly, this Court should reverse the Ninth Circuit's ruling affirming the bankruptcy court's decision and remand for such a determination.

II. THE CREATION OF A "FEDERAL COMMON LAW" OF CLAIMS ALLOWANCE WOULD INVITE FORUM SHOPPING INTO BANKRUPTCY

As this Court observed in *Butner*, the "[u]niform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'" *Butner*, 440 U.S. at 55 (quoting *Lewis* v. *Manufacturers Nat'l Bank*, 364 U.S. 603, 609 (1961)).

These goals are critically important, as both common sense and actual experience demonstrate the very palpable risk that whenever the question of claims allowance is governed in bankruptcy by different standards than those that

prevail outside of bankruptcy, there is a risk that litigants will seek to forum shop into bankruptcy in order to obtain a litigation advantage, without regard to the underlying purposes of bankruptcy law. In response, the courts have been required to develop the doctrine of "good faith," designed to limit access to the chapter 11 bankruptcy process to those debtors whose bankruptcy cases serve legitimate reorganizational purposes, and not those who are led into bankruptcy by a desire to forum shop.

This risk is already present in those few areas where the Bankruptcy Code expressly provides that the allowance of claims is to be determined in a manner that differs from state law. For example, section 502(b)(6) of the Bankruptcy Code provides that a landlord's claim for damages for rejection of a long-term lease of real property is subject to a statutory cap. In *NMSBPCSLDHB, L.P.* v. *Integrated Telecom Express, Inc. (In re Integrated Telecom Express, Inc.)*, 384 F.3d 108 (3d Cir. 2004), the Third Circuit was thus required to address the circumstance of a party that filed for bankruptcy in the absence of any financial distress or legitimate need for bankruptcy protection, but merely in order to take advantage of this particular provision of the Code.

In response, the Third Circuit held that such a bankruptcy case is not filed in good faith, and thus is subject to dismissal "for cause" under section 1112(b) of the Bankruptcy Code. 384 F.3d at 129-130. The court held that Integrated Telecom's petition aimed neither to preserve a going concern nor to maximize property available to satisfy creditors—the two objectives that chapter 11 of the Bankruptcy Code seeks to foster. Instead, the Third Circuit observed Integrated Telecom's likely motive was simply "to gain a litigation advantage" against its landlord by invoking the Code's cap on landlord damages. *Id.* at 124-125.

This risk of forum shopping is particularly acute in the context of mass-tort bankruptcies, in which companies with alleged liability for the sale or manufacture of, for example, asbestos-containing products seek protection in bankruptcy. In certain of these cases, companies whose non-insurance assets may be insubstantial or have already been largely de-

pleted are led into bankruptcy by the tort claimants, who hope to create, in bankruptcy, a more lax claims allowance process that will drive up the company's "liability," and thus create for them a strategic litigation advantage over the company's insurers. *See generally Century Indem. Co.* v. *Congoleum Corp. (In re Congoleum Corp.)*, 426 F.3d 675 (3d Cir. 2005); Mark D. Plevin et al., *Pre-Packaged Asbestos Bankruptcies: A Flawed Solution*, 44 S. Tex. L. Rev. 883 (2003).

Affirming the decision below would open the door to precisely this type of gamesmanship. As this Court observed in *Butner*, no litigant should stand to reap a windfall "merely by reason of the happenstance of bankruptcy." 440 U.S. at 55 (internal quotations omitted).

* * * * *

To facilitate the economic rehabilitation of individuals or troubled businesses, bankruptcy law provides powerful tools with which a court can alter settled legal expectations. Debts can be discharged. Leases can be cut short. All this is possible because federal bankruptcy power, when exercised under federal law, trumps the state law foundations on which the debtor and its creditors ordered their respective rights. *Sturges* v. *Crowninshield*, 17 U.S. 122, 193-194 (1819). The strong medicine bankruptcy law provides thus comes with a crucial limitation: it can only be exercised when it would serve a bankruptcy goal that Congress has identified. That is, "[b]ankruptcy law changes nonbankruptcy law only when the purposes of bankruptcy law require it," Douglas G. Baird, *The Elements of Bankruptcy* 5 (4th ed. 2006), and bankruptcy law suspends state law only where such preemption is express or implied, i.e., "to the extent of the actual conflict with the system provided by the Bankruptcy Act." *Butner*, 440 U.S. at 54 n.9.

The Ninth Circuit's decision below breaks with this critical and long-standing principle, and fundamentally upsets the relationship between bankruptcy and nonbankruptcy law.

CONCLUSION

For the foregoing reasons, the judgment below should be reversed.

Respectfully submitted,

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IN THE
Supreme Court of the United States

TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA,
Petitioner

-v.-

PACIFIC GAS AND ELECTRIC COMPANY,
Respondent

On Writ of Certiorari to the
United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICUS CURIAE* THE SURETY & FIDELITY ASSOCIATION OF AMERICA IN SUPPORT OF PETITIONER TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA

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STATEMENT OF INTEREST OF AMICUS CURIAE

The Surety & Fidelity Association of America ("SFAA")[1] is a trade association of companies licensed to write fidelity and surety bonds in the United States. The approximately 500 members of SFAA are sureties on the vast majority of such bonds furnished in California and other states.

Surety bonds are provided in return for both a premium and an agreement by the bond principal to indemnify the surety against liability, loss and expense, including attorneys' fees, incurred by reason of the execution of the bonds. In the instant case, the contracts between petitioner Travelers Casualty and Surety Company of America, as administrator for Reliance Insurance Company ("Travelers")[2] and respondent Pacific Gas and Electric Company ("PG&E") obligated PG&E to indemnify Travelers for Traveler's attorneys' fees. The Ninth Circuit Court of Appeals refused to enforce the attorneys' fee

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[1] No person or entity other than The Surety & Fidelity Association of America made any monetary contribution to the preparation or submission of this Brief, and counsel for the parties did not author this Brief in whole or in part.

[2] The indemnity agreements named, and the bonds were furnished by, Travelers' predecessor in interest, Reliance Insurance Company.

provisions of the indemnity contracts because the dispute between Travelers and PG&E was decided under federal bankruptcy law instead of state law.

If this Court were to adopt the Rule created by the Ninth Circuit, sureties would be deprived of a part of the consideration promised to induce them to furnish bonds. Indemnity agreements similar to the ones provided by PG&E are routinely required in connection with all types of surety bonds. SFAA's members have an interest in the resolution of the issue presented in this case.

Both Petitioner and Respondent have consented to the filing of this Brief.

SUMMARY OF ARGUMENT

The Ninth Circuit Court of Appeals rejected Travelers' argument that state law should control its claim to recover attorneys' fees incurred in protecting its rights in PG&E's bankruptcy proceeding. Even if federal law applied, however, the Ninth Circuit failed to follow this Court's precedents. The American Rule on attorneys' fees applicable in cases arising under federal law is that fees may be recovered if provided for in an enforceable

contract. Thus, the Ninth Circuit's holding was contrary to both state and federal law.

The Ninth Circuit's Rule dates from *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991), but the authorities cited in *Fobian* do not support its result. There is nothing in the *Fobian* opinion to justify or explain disregarding the American Rule's exception for fees authorized by contract just because the dispute arose under the Bankruptcy Code.

This case presents an important, recurring question that impacts a wide range of contracts in addition to indemnity agreements required in connection with all types of surety bonds. If otherwise valid attorneys fee shifting clauses are arbitrarily disregarded, the attorneys fees that are not collected from defaulting parties will be included in the cost of the prevailing party's products or services and paid for by its customers. It is logical and economic to place the cost of litigation on the losing party that bargained to pay it rather than on non-defaulting customers of the prevailing party.

ARGUMENT

The Bankruptcy Code neither provides generally for recovery of attorneys fees nor prevents the parties to a dispute from shifting attorneys fees by contract. The Ninth Circuit Court of Appeals developed its own Rule that enforced, or refused to enforce, contractual attorneys fee shifting based on the law used to resolve the underlying dispute. If state law controlled the dispute, the Ninth Circuit applied state law to decide the attorneys fee issue. If bankruptcy law controlled the dispute, however, the Ninth Circuit refused to permit shifting of attorneys fees in the absence of bad faith or harassment.

Travelers argues that its attorneys fee claim should have been allowed as a matter of bankruptcy law and that the Bankruptcy Court should have applied California law to the fee claim. SFAA will not repeat those arguments and files this Brief to address an alternative basis to allow the fee claim by applying the American Rule under federal law.

I. The Ninth Circuit Rule

The Ninth Circuit Court of Appeals decision in this case[3] was that "attorneys fees are not recoverable in bankruptcy for litigating issues 'peculiar to federal bankruptcy law.'"[4] The Ninth Circuit's decision did not depend on the attorneys' fee provision of the parties' contract or on which party prevailed. The Court followed a bright line rule that parties cannot contract to shift attorneys' fees incurred litigating issues controlled by bankruptcy law.

In a companion case, *DeRoche v. Arizona Industrial Commission*,[5] the Ninth Circuit stated its Rule as follows:

> However, we consistently have refused to award fees when the substantive

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[3] *Travelers Casualty and Surety Company v. Pacific Gas and Electric Company*, 2006 WL 285977 (9th Cir. February 7, 2006), Petition Appendix page 1a.

[4] Pet. App. p.3a, quoting from *Fobian v. Western Farm Credit Bank*, 951 F.2d 1149, 1153 (9th Cir. 1991).

[5] 434 F.3d 1188 (9th Cir. 2006), a Petition for Writ of Certiorari is pending in the *DeRoche* case, Case No. 05-1439.

> legal question was governed by federal bankruptcy law, rather than "basic contract enforcement questions," even when the underlying contract contains an attorney fee provision enforceable under state law.

(434 F.3d 1191).

The Ninth Circuit decisions in the instant case and *DeRoche* both relied on *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149, 1153 (9th Cir. 1991), *Cert. Den.* 505 U.S. 1220 and 1221 (1992). In *Fobian* the Court explained:

> Where a contract or statute provides for an award of attorneys' fees, a creditor may be entitled to such fees in bankruptcy proceedings. Such an award is governed by state law. . . . However, where the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law, attorney's fees will not be awarded absent bad faith or harassment by the losing party.

(951 F.2d 1153).

Thus, the predicate for the Ninth Circuit's decision in the instant case was that contractual attorneys fee provisions are unenforceable under federal law. If state law had controlled the decision, the Ninth Circuit would have followed California law and enforced the contract. Because Federal bankruptcy law controlled, the Ninth Circuit held that the attorneys fee provisions of the indemnity contracts were not enforceable.

SFAA respectfully suggests that the Ninth Circuit holding conflicts with this Court's application of the American Rule in matters controlled by federal law.

II. The American Rule Under Federal Law Enforces Contractual Attorneys' Fee Provisions

In matters controlled by federal law, the American Rule is to enforce contractual attorneys' fee provisions. *Fleischmann Distilling Corp. v. Maier Brewing Co.*, 386 U.S. 714, 87 S. Ct. 1404, 18 L. Ed.2d. 475 (1967), arose

under the Lanham Act.[6] The Court stated the American Rule as:

> The rule here has long been that attorney's fees are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefor.

(386 U.S. 717, 87 S. Ct. 1407).

F.D. Rich Co., Inc. v. U.S. ex rel. Industrial Lumber Co., Inc., 417 U.S. 116, 94 S. Ct. 2157, 40 L. Ed. 2d 703 (1974), held that an action on the payment bond required by the Miller Act[7] was governed by federal law and the Ninth Circuit erred in resorting to "state policy" to award fees. This Court stated:

> The Miller Act provides a federal cause of action, and the scope of the remedy as well as the substance of the rights created thereby is a matter of federal not state law. Neither respondent nor the court below offers any evidence of congressional intent to

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[6] 15 U.S.C. §§1051, et seq.

[7] 40 U.S.C. §§ 3131, et seq.

> incorporate state law to govern such an important element of Miller Act litigation as liability for attorneys fees.

(417 U.S. 127, 94 S. Ct. 2164).

The Court in *F.D. Rich* also recognized that a contractual attorneys' fee provision would be enforced. The Court, citing *Fleischmann Distilling Corp.*, stated:

> We turn now to the question of whether attorneys' fees were properly awarded respondent as a successful Miller Act plaintiff. The so-called 'American Rule' governing the award of attorneys' fees in litigation in the federal courts is that attorneys' fees 'are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefor.' . . . There was no contractual provision concerning attorneys' fees in this case.

(417 U.S. 126, 94 S. Ct. 2163).

See also, *Summit Valley Industries, Inc. v. Local 112, United Brotherhood of Carpenters and Joiners of America*, 456 U.S. 717, 721, 102 S. Ct. 2112, 2114, 72 L.

Ed.2d 511 (1982)("Under the American Rule it is well established that attorney's fees 'are not ordinarily recoverable in the absence of a statute or enforceable contract providing therefor.'"); *Hall v. Cole*, 412 U.S. 1, 4, 93 S.Ct. 1943, 1945, 36 L. Ed.2d 702 (1973)("Although the traditional American Rule ordinarily disfavors the allowance of attorneys' fees in the absence of statutory or contractual authorization. . ."); *Alyeska Pipeline Service Company v. Wilderness Society*, 421 U.S. 240, 257, 95 S. Ct. 1612, 1621, 44 L. Ed.2d 141 (1975)("Other recent cases have also reaffirmed the general rule that, absent statute or enforceable contract, litigants pay their own attorneys' fees.")

Following *F.D. Rich*, courts, including the Ninth Circuit,[8] have awarded attorneys' fees to successful Miller Act payment bond claimants if their contracts provided for fees. This is not because state law entitled them to fees. It is because the American Rule under federal law enforces fee shifting by contract.

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[8] *United States ex rel. Reed v. Callahan*, 884 F.2d 1180, 1185-1186 (9th Cir. 1989), *Cert. Den. Esto, Inc. v. Callahan*, 493 U.S. 1094 (1990); *United States ex rel. Palmer Construction, Inc. v. Cal. State Elec., Inc.*, 940 F.2d 1260 (1991); *North Star Terminal & Stevedore Co. v. Nugget Construction, Inc.*, 126 Fed. Apx. 348, 2005 WL 487313 (9th Cir. 2005).

Thus, in the instant case, the Ninth Circuit reached a result contrary to both state and federal law. Nothing in the Bankruptcy Code forbids parties from allocating the cost of attorneys' fees by contract. California law and federal law recognize such contracts as an exception to the American Rule. If Congress wanted to forbid enforcement of contractual fee shifting in cases decided under the Bankruptcy Code, it could have done so. In the absence of such a statute, however, the Ninth Circuit was not free to legislate its own Ninth Circuit law contrary to both state law and this Court's decisions on federal law.

III. *Fobian* is not Persuasive Authority for the Ninth Circuit's Rule

The Ninth Circuit Rule at issue in this case rests upon *Fobian v. Western Farm Credit Bank*, supra., but *Fobian* did not explain its failure to apply the American Rule as a matter of federal law to enforce the contractual attorneys fee provision. In *Fobian* the bank successfully opposed confirmation of the Fobians' Chapter 12 plan and sought attorneys fees pursuant to provisions in the promissory note and deed of trust that provided "for the payment of fees and costs incurred in collection of amounts due or enforcement of rights." (951 F.2d 1153). The Court rejected the fee claim.

In each of the four cases that *Fobian* cited in connection with the attorneys fee issue, the attorneys fee claim depended on state law. In *Johnson v. Righetti (In re Johnson)*, 756 F.2d 738 (9th Cir. 1985) the contract provided that the sellers could recover attorneys fees. The buyers defaulted on the loan payments and filed for bankruptcy. The buyers then prevailed in the sellers' action to lift the automatic stay. The buyers had no contractual claim to attorneys fees, but relied on Cal. Civ. Code §1717, which provided that "In any action on a contract" any attorneys fee provision would be mutual for the benefit of the prevailing party. The Court held that the litigation for relief from the automatic stay was not an "action on a contract" and denied recovery of fees pursuant to §1717 because §1717 by its terms did not apply.

In *Grove v. Fulwiler (In re Fulwiler)*, 624 F.2d 908 (9th Cir. 1980), a promissory note obligated the debtor, Mr. Fulwiler, to pay attorneys fees incurred in collection of the note. Mr. Fulwiler successfully opposed the creditor's petition to set aside Mr. Fulwiler's bankruptcy discharge, and Mr. Fulwiler sought attorneys fees. The Court noted that, "Fulwiler based his request for attorney's fees upon a state statute, ORS (Oregon Revised Statutes) 20.096 which makes an attorney's fees clause reciprocally binding

regardless of the actual wording of the clause." (624 F.2d 909). Since the non-dischargeability proceeding was purely a question of federal law, the debtor's claim to fees was denied.

Merced Production Credit Association v. Sparkman (In re Sparkman), 703 F.2d 1097 (9th Cir. 1983) awarded fees to the debtor who prevailed on a state law counterclaim against a lender. The Court stated, "Thus, Sparkman's entitlement to attorneys' fees in the present case turns upon state law, not the American Rule."

Finally, *Collingwood Grain, Inc. v. Coast Trading Company, Inc. (In re Coast Trading Company, Inc.)* , 744 F.2d 686 (9th Cir. 1984) denied both sides' attorneys fee claims. The dispute involved an unpaid seller's rights under the Uniform Commercial Code, and the Court noted that both claims depended on Oregon statutes. The Court also held, "attorneys fees are not available for the litigation of federal bankruptcy issues under a contract which provides for attorneys' fees for enforcement of the contract."

Thus, in each of the cases cited in *Fobian*, there was no otherwise applicable contract for fees. Either the

contract did not cover the fees incurred or the fee claim depended on a state statute rather than the contract. Nevertheless, the Court adopted a broadly worded Rule that attorneys fees would not be awarded if the issues litigated were peculiar to federal bankruptcy law.

There is some logic to holding that attorneys fees that can be claimed only under a state statute are not recoverable in a case controlled entirely by federal bankruptcy law or that a contract that provides for fees incurred to enforce the contract does not entitle a party to fees incurred in connection with some other type of claim. In the instant case, however, Travelers' right to fees does not depend on any state statute, and the indemnity contracts obligate PG&E to pay Travelers' fees incurred "by reason of the execution of the bonds," not just fees to enforce PG&E's indemnity contracts.

Travelers incurred fees to protect its rights in PG&E's bankruptcy proceeding. The lower courts denied recovery of those fees without regard to the terms of the indemnity contracts or the identity of the prevailing party. The Ninth Circuit squarely held that the fees could not be recovered because federal bankruptcy law controlled the litigation.

The American Rule applicable to matters controlled by federal law, however, permits shifting of attorneys fees by contract. The Ninth Circuit's decision in *Fobian*, followed in the instant case, conflicts with this Court's application of the American Rule under federal law and should be reversed.

IV. Logic and Public Policy Favor Reversal of the Courts Below

PG&E could have met its obligations to injured employees by purchasing workers compensation insurance. Instead of paying to have an insurer assume the obligations, however, PG&E chose to self-insure and pay the workers itself. Under California law, it had to provide security for its obligations to the injured workers.[9] A surety bond was one of the permitted forms of security.[10]

Unlike an insurer, the surety on the bond did not take over primary responsibility for the benefits. PG&E remained primarily liable, and the surety merely guaranteed PG&E's performance. The risk the surety ran was that workers would be owed benefits and that PG&E would be unable to pay them.

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[9] Cal. Labor Code §3701.

[10] Cal. Labor Code §3701(d).

To induce Travelers to become surety on the bonds, and thus assume a potential $100 million liability, and to keep the cost of the bonds as low as possible, PG&E executed the indemnity agreements. In Paragraph Second of the first two Agreements, PG&E promised:

> SECOND: To indemnify, and keep indemnified, and hold and save harmless the Surety against all demands, claims, loss, costs, damages, expenses and attorneys' fees whatever, and any and all liability therefor, sustained or incurred by the Surety by reason of executing or procuring the execution of any said Bond or Bonds, or any other Bonds, which may be already or hereafter executed for or at the request of the Undersigned, or renewal or continuation thereof; or sustained or incurred by reason of making any investigation on account thereof, prosecuting or defending any action brought in connection therewith, obtaining a release therefrom, recovering or attempting to recover any salvage in connection therewith or enforcing by litigation or otherwise any of the agreements herein

> contained. Payment of amounts due Surety hereunder together with legal interest shall be payable upon demand.

(Excerpts of Record in the Ninth Circuit at pp. 41 and 45).

The third agreement stated at its second paragraph, "PG&E Corporation agrees to indemnify the Surety and hold [it] harmless in respect of any and all loss, damages, claims, costs, premiums, expenses and reasonable attorney's fees which the Surety may incur by reason of its having furnished the aforesaid Workers Compensation Bond." (Excerpts of Record at p. 51).

PG&E did not just agree to indemnify Travelers for losses paid under the bonds.[11] It also promised to indemnify Travelers for expenses, including attorneys' fees, incurred "by reason of executing" the bonds. Paragraph Second then goes on to obligate PG&E to pay any attorneys' fees incurred in connection with enforcement of the indemnity agreement. Thus, PG&E's promise to pay Travelers' attorneys' fees was not limited to actions on the indemnity contract itself. Any fees incurred by reason of the execution of the bonds were covered.

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[11] Indeed, such a promise would be largely superfluous because Cal. Civ. Code §2847 would obligate PG&E as principal on the bonds to pay Travelers for any losses.

Surety bonds are required in connection with a multitude of activities including all public construction projects over a minimal size.[12] Indemnity agreements substantially similar to the ones PG&E provided Travelers are routinely obtained in connection with all kinds of surety bonds.[13] These agreements help reduce the cost of bonds and assure that any losses and expenses are paid by the bond principal or other persons or entities who agree to act as indemnitors for the principal's obligations to the surety. If bond principals do not have to live up to their promises because a dispute is decided under federal bankruptcy law instead of state law, the loss experience and costs of bonds will increase.

The same is true for other types of transactions in which attorneys' fee shifting provisions are used. If one party is obligated to pay the other party's attorneys' fees, the indemnified party can charge less for its products or

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[12] For federal construction, the Miller Act, 40 U.S.C. §§ 3131, et seq., requires performance and payment bonds. In California, Civ. Code §3247 requires payment bonds on public construction contracts.

[13] See, Klinger, et al., *The Surety's Indemnity Agreement* (American Bar Association 2002) and Shahinian, "The General Indemnity Agreement" in Gallagher, ed. *The Law of Suretyship, 2nd Ed.* (American Bar Association 2000) at pp. 487-525.

services. It recovers the cost of enforcing the contract from the defaulting party. If such an indemnification provision is unenforceable, the attorneys' fees have to be factored into the cost of the products or services. Then, all parties purchasing the products or services pay an increased price. The attorneys' fees are spread over all customers rather than being paid by the defaulting party.

In the instant case, PG&E is well able to pay Travelers' attorneys' fees, but the Ninth Circuit rule bars enforcement of the attorneys' fee provisions in the indemnity agreements. In this one instance, the consequences to Travelers' other customers may be minimal, but applied to the myriad of contracts with attorneys' fee shifting provisions, the cumulative effect of the Ninth Circuit rule is substantial.

CONCLUSION

This Court should reverse the Ninth Circuit Court of Appeals and hold that the American Rule, as articulated by this Court in matters of federal law, requires enforcement of otherwise valid contractual fee shifting provisions in cases governed by federal bankruptcy law.

Respectfully submitted,

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